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In the Supreme Court of the United States

OCTOBER TERM, 1943

No. 250

LELAND STANFORD JUNIOR UNIVERSITY and ELMER H. SHINE,
Petitioners,

vs.

THE NATIONAL SUPPLY COMPANY, a corporation,
Respondent.

Petition for Writ of Certiorari

To the United States Circuit Court of Appeals for the Ninth Circuit

and

Brief in Support of Petition

JOHN T. PIGOTT
1500 Balfour Building,
San Francisco, California
Attorney for Petitioners

HENRY D. COSTIGAN,
MORRIS M. DOYLE,
McCUTCHEN, THOMAS, MATTHEW, GRIFFITHS & GREENE,
1500 Balfour Building,
San Francisco, California
Of Counsel.

PARKER PRINTING COMPANY, 545 SANSOME STREET, SAN FRANCISCO

Index to Petition

SUBJECT INDEX

	Page
PETITION FOR WRIT OF CERTIORARI	1
Summary Statement of the Matter Involved	2
Statement of Basis of Jurisdiction	8
Questions Presented and Reasons Relied Upon for Allowance of the Writ	8
Prayer	15
Certificate of Counsel	16

Table of Cases and Authorities Cited

TABLE OF CASES

Pages

Beechwood Securities Corp., Inc. v. Associated Oil Co. (C.C.A. 9, 1939) 104 Fed.(2d) 537 10

Cole v. National Cash Credit Ass'n. (Del., 1931) 18 Del. Ch. 47, 156 Atl. 183 10

Commissioner v. Textile Mills Securities Corp. (C.C.A. 3, 1940) 117 Fed.(2d) 62, 71 14

Equitable Life Insurance Co. v. Halsey etc. Co. (1941) 312 U.S. 410 9

Falter v. United States (C.C.A. 2, 1928) 23 Fed.(2d) 420, 424 (Cert. den. 277 U.S. 590) 9

May v. Midwest Refining Co. (C.C.A. 1, 1941) 121 Fed.(2d) 431, 438 (Cert. den. 314 U.S. 668) 10

Rutherford v. Rideout Bank (1938) 11 Cal.(2d) 479, 485-6; 80 Pac.(2d) 978, 981-2 9

Seeger v. Odell (1941) 18 Cal.(2d) 409, 414-5; 115 Pac.(2d) 977, 980-81 9

Textile Mills Securities Corp v. Commissioner (1941) 314 U.S. 326 14

W. P. Walker & Co. v. Walbridge (C.C.A. 5, 1905) 136 Fed. 19 (Cert. den. 199 U.S. 605) 9

STATUTES CITED

General Corporation Law of Delaware, Sections 59-61 (App. i-viii) ..2, 3, 4

Judicial Code:

Section 24(1) (U.S.C.A., Title 28, Section 41(1)) 8

Sections 28 and 29 (U.S.C.A., Title 28, Sections 71 and 72) 8

Section 240(a) (U.S.C.A., Title 28, Section 347(a)) 8

Securities Act (App. viii-ix) 3, 4, 7, 11

OTHER AUTHORITIES CITED

Federal Rules of Civil Procedure, Rule 52(a) 12

Supreme Court Rule 38, Subdivision 5(b) 8

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LELAND STANFORD JUNIOR UNIVERSITY and ELMER H. SHINE,
Petitioners,

vs.

THE NATIONAL SUPPLY COMPANY, a corporation,
Respondent.

Petition for Writ of Certiorari

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioners, Leland Stanford Junior University and Elmer H. Shine, respectfully pray that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Ninth Circuit (R. 3000-1) entered April 1, 1943, in a case numbered and entitled on its docket No. 10,270, *The National Supply Company, a corporation, Appellant, vs. Leland Stanford Junior University and Elmer H. Shine, Appellees,* reversing a judgment of the United States District Court

for the Northern District of California, Southern Division, in favor of petitioner, Leland Stanford Junior University, and against respondent, The National Supply Company, in the sum of $260,840.38, together with costs of $1,670.66 (R. 313-15). Petition for rehearing was denied by the Circuit Court of Appeals on May 22, 1943 (R. 3001).

SUMMARY STATEMENT OF THE MATTER INVOLVED

Petitioner Shine is a mere nominee and petitioner Leland Stanford Junior University, herein called "Stanford" or "plaintiff", will be treated as sole plaintiff. Stanford sued respondent, The National Supply Company, a Pennsylvania corporation, herein called "defendant", because of defendant's responsibility for the liabilities of its predecessors in a statutory consolidation. These predecessors were The National Supply Company of Delaware, herein called the "Delaware corporation", and its subsidiary, Spang, Chalfant & Co., Inc., a Pennsylvania corporation, herein called "Spang".

Stanford owned as an investment 1300 shares of preferred stock in the Delaware corporation, on which large amounts of dividends were in arrears. The Delaware corporation and Spang consolidated under Delaware and Pennsylvania law,* and as a result Stanford's stock and the arrears of dividends thereon were automatically converted into certain stocks of defendant.

Stanford sued defendant for damages caused by the consolidation, asserting three independent causes of action,

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*The Delaware law, here involved, consists of Secs. 59-61 of the General Corporation Law of Delaware. The text of these sections is set forth in the Appendix to the attached Brief, pages i to viii incl.

each of which alone justified the judgment sought. Two were for frauds and the third for violation of the Federal Securities Act of 1933. The District Court found the facts for plaintiff on all the issues (R. 225-87) and entered judgment for $260,840.38* and costs (R. 313-15).

The trial court found two intentional frauds, which we call the primary fraud and the secondary fraud. The primary fraud was the adoption of an unfair plan of consolidation which deprived Stanford and other preferred stockholders of more than $6,000,000 in values—between one-third and one-quarter of the total values of their old preferred stock and accrued dividends thereon—transferring such values to the common stock. The findings were not only that the plan had this unfair result (R. 249-51 and 274), but that the result was deliberately designed by the directors of the Delaware corporation for the wrongful purpose of benefiting their own common stock (R. 235-9, 246-7, 275, 278).

The secondary fraud upon Stanford consisted of the concealment by the directors of the right of every stockholder of the Delaware corporation to obtain the fair value of his stock pursuant to an appraisal under the Delaware statute† and the further concealment of the fact that if a stockholder did nothing about his stock he could not retain that stock under the plan, but would find the stock automatically converted into shares of the consoli-

*This amount was based on plaintiff's tender of its stock to defendant and the deposit of such stock with the Court pursuant to such tender (R. 303-13).

†A right which we call herein the "Delaware appraisal right" and which is granted by Sec. 61 of the Delaware General Corporation Law, Appendix to attached Brief, pages vi-viii.

dated corporation (defendant).* The District Court found not only that the Delaware appraisal right and automatic conversion were concealed by the letter which the directors of the Delaware corporation sent to Stanford and other stockholders (R. 259-62), but that these concealments were intentional and deliberate on the part of the directors, being for the purpose of avoiding the payment of cash to stockholders, who might exercise the Delaware appraisal right if they knew the facts (R. 259, 263-4, 281). The trial court further found that Stanford relied on the letter from the directors as a summary of the consolidation plan and was thereby misled into doing nothing until too late, thus losing its Delaware appraisal right and losing also its old shares by reason of their automatic conversion into stock of defendant (R. 259-65).

On the Securities Act cause of action, the District Court found that the letter offering defendant's shares to plaintiff in exchange for the old stock was sent through the mails but without registration of the new stock under the Securities Act (R. 279, pars. 46-7).

The Circuit Court of Appeals reversed the District Court (R. 3000-1) without expressly setting aside any finding or considering the sufficiency of the evidence to support the findings or the sufficiency of the findings to support the judgment.† Primarily the reversal is based

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*A result which we call herein "automatic conversion" and which is provided for in Sec. 59 of the Delaware General Corporation Law, Appendix to attached Brief, p. i.

†See the appellate court's opinion (R. 2986-3000), hereinafter called the "Reversing Opinion". It is reported in 134 F.(2d) at 689-694 incl.; but references herein are to the copy in the Record.

upon the holding that Stanford's representatives were negligent in failing to study the detailed "Agreement and Joint Plan of Consolidation",* which accompanied the letter from the directors. According to the Reversing Opinion, a study of the plan and agreement would have led to the discovery by Stanford of the Delaware appraisal right and automatic conversion (R. 2996-8).

This holding of negligence is made despite the following findings by the District Court:

1. The finding that the letter on which Stanford relied and which concealed the Delaware appraisal right and automatic conversion, appeared to be, and was intended by the directors to appear as, a summary of the plan and agreement (R. 259);† so that the Reversing Opinion either ignores this fact or else holds that it is negligence for a stockholder to rely on a letter sent to him by the directors of his corporation, which summarizes an important corporate plan.
2. The findings by the District Court which demonstrate, as above explained, that each of the frauds was wilful and deliberate; so that the Reversing Opinion either ignores these facts or else holds that contributory negligence is a defense to a claim for intentional fraud perpetrated by fiduciaries (directors) against their beneficiary (a stockholder).
3. The fact which is implicit in the findings, namely, that the asserted negligence—plaintiff's failure to investigate further—did not in any way contribute to the primary fraud—the adoption of the unfair plan. The plan, of course, was the work of the directors alone. All that plaintiff's failure to investigate did

*Herein called the "plan and agreement".

†This finding is based on an admission by defendant in the pleadings (R. 35, 162).

with respect to the unfair plan was to cause plaintiff to lose one available remedy for this fraud, namely, the Delaware appraisal right. By holding that plaintiff's negligence, resulting in loss of this one remedy, also bars another remedy, in this case plaintiff's right to recover in an action for damages for fraud, the Reversing Opinion necessarily decides that the Delaware appraisal right is an exclusive remedy.

The Reversing Opinion also mentions "estoppel" and "laches", at least as makeweight grounds for reversal (R. 2999). In so doing it apparently relies in part on the theory that after the consolidation Stanford accepted checks for dividends on the stock of the consolidated corporation (defendant). See the statement to this effect in the opinion (R. 2989). However, the District Court found upon uncontradicted evidence that the dividend checks were cashed, not by Stanford itself but by its bank, and without any knowledge that they related to stock of the consolidated corporation; also that as soon as Stanford discovered that they were dividends on the new stock it immediately tendered them with interest to defendant (R. 282).

The Reversing Opinion similarly ignores other important findings in its apparent holding of laches and estoppel. (Compare the opinion at R. 2999 with the findings at R. 264 and 282-5). The most important example of this should be mentioned here in view of the fact that the decision on this subject seems to be based largely on mere delay. Obviously mere delay for not over seven months*

*The Delaware corporation stockholders' meeting, which voted the plan, was held October 11, 1937 (R. 279-80). This suit was filed May 11, 1938 (R. 146) and summons was served on May 12, 1938 (R. 13).

could not result in laches or estoppel unless the delay caused prejudice. And yet the Reversing Opinion completely ignores the District Court finding which shows that defendant was not prejudiced by plaintiff's delay, namely, that if plaintiff had acted at the earliest possible time neither the predecessor companies nor the directors would have followed any other course than that which they did follow, except that they might have long since paid to plaintiff the value of its shares (R. 283).†

With respect to the Securities Act, the Reversing Opinion simply holds that an exchange of stocks in a consolidation does not involve a "sale" and therefore the Act is not applicable (R. 2999). No reason is given except a reference to the views of the Securities and Exchange Commission as expressed in an *amicus curiae* brief.‡

For reasons which will appear hereinafter, plaintiff filed a petition for a rehearing by all seven Judges of the Circuit Court of Appeals sitting in bank. This petition, which is described in the Record as one "for a rehearing * * * and for a hearing en banc" (R. 3001), was considered solely by the same three Judges who rendered the Reversing Opinion, being denied by them without the participation of any other Judge (R. 3001).

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†This finding is unassailable by defendant because based upon the express testimony of its President, who was also President of the Delaware corporation (R. 1084-93).

‡The Commission's brief was confined to legal questions under the Securities Act and was careful to take no position on the fraud points.

STATEMENT OF BASIS OF JURISDICTION

1. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, U.S.C.A., Title 28, Section 347(a). The jurisdiction of the District Court was invoked under Section 24(1) of the Judicial Code, U.S.C.A., Title 28, Section 41(1) pursuant to appropriate proceedings for removal from the state court because of diversity of citizenship under Sections 28 and 29 of the Judicial Code, U.S.C.A., Title 28, Sections 71 and 72. (See R. 1-17.)

2. The judgment of the Circuit Court of Appeals was entered April 1, 1943 (R. 3000-1). Petition for rehearing, filed April 30, 1943, was denied May 22, 1943 (R. 3001).

QUESTIONS PRESENTED
and
REASONS RELIED UPON FOR ALLOWANCE OF THE WRIT

This petition presents at least five important questions, each of which involves one or more special and important reasons for allowance of the writ within the meaning of subdivision 5(b) of Rule 38 of the Supreme Court Rules. Because of this complexity, we propose to state each question and then follow with the reasons for allowance of the writ as to that question, rather than to first list the questions and then give the reasons separately.

Question 1: If plaintiff was negligent in relying upon a summary of a consolidation plan sent by the directors of plaintiff's corporation to plaintiff as a stockholder, instead of studying the detailed plan itself, is such negligence a defense to causes of action for deliberate and wilful frauds

perpetrated by the directors—fiduciaries—against plaintiff —their beneficiary?

Reasons for Writ on Question 1: The Circuit Court of Appeals has squarely held in this case that contributory negligence is a complete defense to a claim for intentional fraud perpetrated by a fiduciary against his beneficiary. This is not only a decision on an important and basic question of law, but it is directly in conflict with the local law of California, where the fraud was perpetrated, as established by applicable decisions of the California Supreme Court,* and indeed, it is in conflict with local law as established everywhere by applicable decisions, including those of the United States Supreme Court and other Circuit Courts of Appeals.†

Question 2: If plaintiff's failure to investigate a detailed corporate plan more fully is negligence, is it *contributory* negligence constituting a good defense to plaintiff's cause of action based on the adoption of an unfair plan, when this negligence did not contribute in any way to the fraud consisting of the adoption of the unfair plan, but merely resulted in the loss by plaintiff of one alternative remedy for such fraud, namely, the statutory appraisal right to obtain fair value for its shares?

**Seeger v. Odell* (1941) 18 Cal.(2d) 409, 414-5; 115 Pac.(2d) 977, 980-81; *Rutherford v. Rideout Bank* (1938) 11 Cal.(2d) 479, 485-6; 80 Pac.(2d) 978, 981-2; and other cases cited in attached Brief, pages 21-2.

†*Equitable Life Insurance Co. v. Halsey etc. Co.* (1941) 312 U.S. 410; *W. P. Walker & Co. v. Walbridge* (C.C.A. 5, 1905) 136 Fed. 19 (Cert. den. 199 U.S. 605); *Falter v. United States* (C.C.A. 2, 1928) 23 Fed.(2d) 420, 424 (Cert. den. 277 U.S. 590); and other cases cited in attached Brief, pages 21-2.

Reasons for Writ on Question 2: By holding that plaintiff's negligence, resulting in loss of the statutory appraisal remedy, also bars one of plaintiff's alternative remedies, namely, an action for damages for fraud, the Circuit Court of Appeals necessarily decides that the Delaware appraisal statute provides an exclusive remedy. This decision squarely conflicts with other applicable cases, not only decisions of state courts, including the Delaware Court of Chancery,* but also one by another Circuit Court of Appeals in which certiorari was denied,† and even a dictum of another group of Judges of the Ninth Circuit.‡ All these cases hold that where an appraisal statute does not expressly provide that it is exclusive (as does the California statute), it is not to be construed as exclusive, and other remedies are permitted. On this important question of law there is thus both conflict with local decisions and conflict with another circuit, requiring certiorari.

Question 3: Although the issuance of stock by a corporation in exchange for other stock is ordinarily a "sale" within the meaning of the Federal Securities Act of 1933, is such issuance of stock prevented from being a "sale" where it occurs in a consolidation or other corporate transaction in which the exchange is brought about under state law by vote of the directors and stockholders acting in their corporate capacities?

**Cole v. National Cash Credit Ass'n.* (Del., 1931) 18 Del. Ch. 47, 156 Atl. 183, and see other state court cases cited in attached Brief, page 28.

†*May v. Midwest Refining Co.* (C.C.A. 1, 1941) 121 Fed.(2d) 431, 438 (Cert. den. 314 U.S. 668).

‡*Beechwood Securities Corp., Inc. v. Associated Oil Co.* (C.C.A. 9, 1939) 104 Fed.(2d) 537, at page 540, last paragraph and footnote 2.

Reasons for Writ on Question 3: The registration requirements of the Federal Securities Act are applicable to a "sale" of stock or an offering of such stock for "sale".* The Securities and Exchange Commission, through its counsel, has taken the position that while ordinarily an exchange of stock involves a sale, this is not true where the exchange takes place under a statutory consolidation, merger or other reorganization pursuant to state law, in which the plan is adopted by action of the directors and stockholders, each acting as a body by a specified majority vote. The Circuit Court of Appeals here follows this view of counsel for the Securities and Exchange Commission, but without discussion of the reasons, merely referring to the *amicus curiae* brief of the Commission, which is of course not generally available to persons interested in the question (R. 2999-3000). The specific holding here is that an offer of an exchange in a consolidation is not an offering for "sale" which requires registration.

The question whether registration is required in case of the issuance of securities in a consolidation, merger or reorganization plan is of great importance throughout the country and raises a question of Federal law which has not been, but should be, settled by the Supreme Court, particularly in view of the manner in which the Circuit Court of Appeals has disposed of the question, i.e., without indicating its own reasoning.

So far as we know, this is the first reported case in which this problem has been raised. We have received numerous inquiries as to the status of the

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*The applicable provisions of the Securities Act are set forth in the Appendix to the attached Brief, pages viii-ix.

case from counsel in various parts of the country. These indicate how important it is to have the law established by the Supreme Court, so that attorneys may advise their clients as to whether or not to register securities issued in the many corporate reorganizations continually taking place.

Question 4: Is it correct practice for the Circuit Court of Appeals to set aside important findings of the District Court without consideration of the supporting evidence or other cause?

Reasons for Writ on Question 4: Rule 52(a) of the Federal Rules of Civil Procedure forbids any appellate court from setting aside a finding of fact unless clearly erroneous and the same rule affirmatively requires that due regard shall be given to the opportunity of the trial court to judge of the credibility of the witness. Here the Circuit Court of Appeals violates this rule by setting aside findings through ignoring them, without making any attempt to determine whether or not they are supported by the evidence. As we have pointed out above, these findings, so ignored, include some of the most important findings which, if given weight, would have necessarily altered the decision of the appellate court. One of these was the finding that the letter on which plaintiff relied was intended as, and appeared to be, a summary of the plan and agreement (above, p. 5). This finding demonstrated that plaintiff was not negligent in relying on the letter. Other important findings which were similarly ignored include the findings as to the wilful and deliberate character of the frauds of the directors (above, pp. 3-5), which should have prevented the appellate court from sus-

taining negligence as a defense, and the numerous findings which negatived the existence of laches or estoppel (above, pp. 6-7).

We submit that the Circuit Court of Appeals for the Ninth Circuit has so far departed from the accepted and usual course of judicial proceedings in its treatment of findings of fact that the Supreme Court's power of supervision should be exercised to require the correct practice.

Question 5: When a Circuit Court of Appeals decision conflicts with a prior opinion of a different group of Judges of the same Court and also conflicts with applicable decisions as to local law and departs from accepted appellate procedure, and when the losing party petitions for a rehearing by the entire Court *in bank* in an effort to have these errors corrected, is it proper for the Circuit Court of Appeals to have this petition passed upon solely by the three Judges who participated in the original erroneous opinion (and who are a minority of the Court) without participation by any other Judge?

Reasons for Writ on Question 5: In this case plaintiffs deemed that they were entitled to a rehearing by the entire Circuit Court of Appeals in bank, because (if for no other reason) the Reversing Opinion conflicted with a prior opinion of a different group of Judges of the same Court, as explained under Question 2 above. They also felt that the conflicts with other decisions on local law, including opinions of other Circuit Courts of Appeals, as explained under Questions 1 and 2 above, and the departure from correct appellate procedure, as explained under Question 4 above, were such as to

justify a rehearing in bank. They filed a petition for such a rehearing, which was treated by the Circuit Court of Appeals as a combined petition for rehearing and for a *hearing in bank* (R. 3001). However, as the Record shows, this petition was passed upon solely by the same three Judges who rendered the opinion in the first instance, without participation by any one of the other four Judges of the seven-judge Court (R. 3001).*

This may be correct practice, but, if so, the result is that as a practical matter a petition for rehearing by the Circuit Court of Appeals in bank is meaningless, since the Judges who first heard the case would not normally grant a petition to have their own decision reviewed by the entire Court unless they believed such decision doubtful, in which case they would be equally willing to grant an ordinary petition for rehearing, so that a rehearing in bank would be unnecessary. And yet the Supreme Court held in

Textile Mills Securities Corp. v. Commissioner
(1941) 314 U.S. 326

that a Circuit Court of Appeals has the right to hear an appeal in bank. In that case it affirmed a decision of the Circuit Court of Appeals for the Third Circuit in which the opinion said that where a difference of opinion between different groups of Judges has arisen, "it is advisable that the whole court have the opportunity, if it thinks it necessary, to hear and decide the question" (117 Fed.(2d) 62, 71). How can the

*We understand that pursuant to established practice in the Ninth Circuit the petition was not examined on its merits by any of such other four Judges, but that after a cursory examination as to its character by the presiding Judge, it was referred solely to the three Judges who had already heard the appeal.

other Judges determine whether they are so minded, if the practice of the Court prevents them from reading the petition which puts the question?

We do not know what should be established as correct practice for rehearings in bank, but the problems involved raise important questions of Federal law and procedure as to which there is no existing authority, so far as we know, and which therefore should be passed upon by the Supreme Court. We venture to suggest that, at the very least, the Supreme Court might indicate whether or not the respective Circuit Courts of Appeals have full authority to decide such questions, as by adopting their own rules concerning rehearings *in bank*. Thus certiorari is called for on this point alone.

WHEREFORE, petitioners pray that a writ of certiorari be issued out of and under the seal of this Honorable Court directed to the United States Circuit Court of Appeals for the Ninth Circuit, commanding that court to certify and send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the Record and of all proceedings in the case numbered and entitled on its docket No. 10,270, *The National Supply Company, a corporation, Appellant, vs. Leland Stanford Junior University and Elmer H. Shine, Appellees,* and that the judgment of said Circuit Court of Appeals be reversed, and that the judgment of the United States District Court for the Northern District of California, Southern Division, in favor of petitioner Leland Stanford Junior University against defendant in the sum of $260,840.38, together with costs of $1,670.66, which judgment was reversed by said Circuit

Court of Appeals, be affirmed by this Court, and that your petitioners have such other and further relief in the premises as to this Court may seem proper.

JOHN T. PIGOTT,
Attorney for Petitioners.

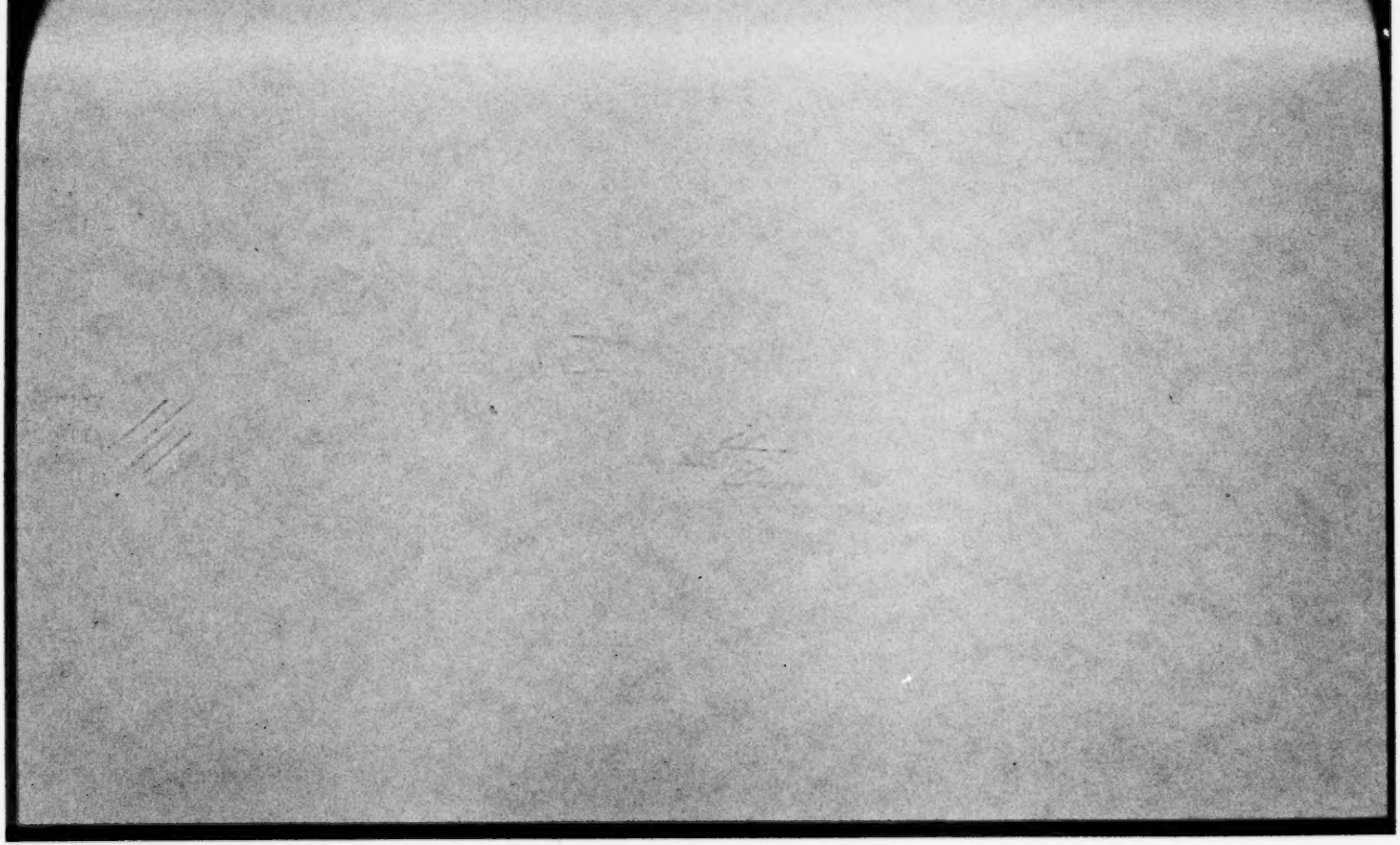
HENRY D. COSTIGAN
MORRIS M. DOYLE
McCUTCHEN, THOMAS, MATTHEW, GRIFFITHS & GREENE,
of Counsel

Dated: San Francisco, California, August 2, 1943.

CERTIFICATE OF COUNSEL

The undersigned counsel for petitioners in the above and foregoing Petition for Writ of Certiorari hereby certifies that in his judgment said Petition is well founded and is not interposed for delay.

JOHN T. PIGOTT



Index to Brief

SUBJECT INDEX

	Page
BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI	1
I. Statement of Jurisdiction	1
II. Opinions Below	2
III. Judgments of District Court and Circuit Court of Appeals	2
IV. Concise Statement of the Case	2
V. Specification of Errors	3
VI. Summary of Argument	5
VII. Argument	8
1. The Circuit Court of Appeals Erred in Holding That Contributory Negligence, if Established, Is a Good Defense to Wilful and Deliberate Frauds by Directors Against a Stockholder	8
The Findings of Deliberate Intent to Defraud	8
(a) The Primary Fraud—Adoption of an Unfair Plan	8
(b) The Secondary Fraud—Concealment of the Appraisal Remedy and of Automatic Conversion	13
The Reversing Opinion Sustains the Defense of Negligence	16
The Conclusion That Contributory Negligence Is a Defense to Wilful Fraud by Fiduciaries Is Contrary to the Local Law of California and All Other States and Conflicts with Decisions of the Supreme Court and Other Circuit Courts of Appeals	20
2. The Circuit Court of Appeals Erred in Holding That Plaintiff's Negligence, Which Resulted Only in Loss of Its Delaware Appraisal Remedy, Also Bars Plaintiff's Action at Law for Damages	23
3. The Circuit Court of Appeals Erred in Holding That the Exchange of Stock for Stock in a Consolidation Was Not a "Sale" Within the Meaning of the Federal Securities Act of 1933	29

Page

4. The Circuit Court of Appeals so Completely Ignores Important Findings of the District Court as to Set Aside Such Findings Without Cause and Contrary to Rule 52(a) of the Federal Rules of Civil Procedure..... 34

   (a) Findings of Deliberate Intent to Defraud..... 35

   (b) The Finding Which Negatives Negligence..... 35

   (c) Numerous Findings Which Completely Answer Claims of Estoppel or Laches..... 36

5. The Circuit Court of Appeals Erred in Having Plaintiff's Petition for a Rehearing by the Entire Court in Bank Passed Upon Solely by the Three Judges Who Decided the Case in the First Instance, Constituting Less Than a Majority of the Appellate Court..... 40

Table of Cases and Authorities Cited

CASES CITED

Pages

Albany Savings Institution v. Burdick (1881) 87 N.Y. 40, 49..... 21

Allied Chemical & Dye Corporation v. Steel & Tube Co. (1923) 14 Del. Ch. 1, 120 Atl. 486..... 12

American Insurance Co. v. Scheufler (C.C.A. 8, 1942) 129 Fed.(2d) 143, 146 24

Barnett v. Philadelphia Market Co. (Pa., 1907) 218 Pa. 649, 67 Atl. 912 28

Barron Estate Co. v. Woodruff Co. (1912) 163 Cal. 561, 574-7; 126 Pac. 351, 356-8..... 22

Beechwood Securities Corp., Inc. v. Associated Oil Co. (C.C.A. 9, 1939) 104 Fed.(2d) 537, 540, 541.....28, 29

Blakeslee v. Wallace (C.C.A. 6, 1930) 45 Fed.(2d) 347, 352..... 22

Boyd v. N. Y. & H. R. Co. (D.C., S.D., N.Y., 1915) 220 Fed. 174 13

Cole v. National Cash Credit Ass'n. (Del., 1931) 18 Del. Ch. 47, 156 Atl. 183.....26, 29

Directors etc. of Central Railroad Co. of Venezuela v. Kisch (House of Lords, 1867) L.R. 2 H.L. (E. & I. App.) 99, 120-1..... 21

Edward v. Ioor (1919) 205 Mich. 617, 172 N.W. 620..... 30

Equitable Life Insurance Co. v. Halsey etc. Co. (1941) 312 U.S. 410, 426 .....15, 21, 23

Falter v. United States (C.C.A. 2, 1928) 23 Fed.(2d) 420, 424 (Cert. den. 277 U.S. 590)..... 22

Federal United Corp. v. Havender (Del., 1940) 11 Atl.(2d) 331, 339-343 (dictum only).....13, 16

Fry v. Board of Education (1941) 17 Cal.(2d) 753, 761; 112 Pac. (2d) 229, 234-5..... 38

Goodisson v. North American Securities Co. (1931) 40 Ohio App. 85, 178 N.E. 29.....13, 28

Griffith v. Parks (1911) 165 Ill. App. 337..... 22

Pages

Indemnity Insurance Co. v. Kircher (1934) 47 Ohio App. 140, 191 N.E. 374 30

James-Dickinson Co. v. Harry (1927) 273 U.S. 119, 121, 126..... 25
Jones v. Missouri-Edison Electric Co. (C.C.A. 8, 1906, 1912, 1913) 144 Fed. 765; 199 Fed. 64; 203 Fed. 945 (Cert. den. 229 U.S. 615) 13

Langan v. Francklyn (1892) 20 N.Y.S. 404, 413-414..... 28
London & San Francisco Bank v. Dexter Horton & Co. (C.C.A. 9, 1903) 126 Fed. 593, 601-2 (Cert. den. 194 U.S. 631)..... 38

Magar v. Hammond (1906) 183 New York 387; 76 N.E. 474; 3 L.R.A. (N.S.) 1038..... 8
Martin v. Burford (C.C.A. 9, 1910) 181 Fed. 922, 926..... 21
May v. Midwest Refining Co. (C.C.A. 1, 1941) 121 Fed.(2d) 431, 438, (Cert. den. 314 U.S. 668)..... 27

Northern Pac. Ry. v. Boyd (1913) 228 U.S. 482, 508-10 (affirming 177 Fed. 804, C.C.A. 9, 1910)..... 38

Outwater v. Public Service Corp. of N. J. (1928) 103 N.J.Eq. 461, 143 Atl. 729 (Aff'd 104 N.J.Eq. 490; 146 Atl. 916)..... 13, 28

Philpott v. Superior Court (1934) 1 Cal.(2d) 512; 36 Pac.(2d) 635 25

Russell v. Todd (1940) 309 U.S. 280, 287..... 38
Rutherford v. Rideout Bank (1938) 11 Cal.(2d) 479, 485-6; 80 Pac.(2d) 978, 981-2..... 22

Schweyer & Co. v. Mellon (1917) 196 Mich. 590; 162 N.W. 1006 22
Scott v. Arden Farms Co. (Del. Ch., 1942) 28 Atl.(2d) 81..... 25
Securities and Exchange Commission v. Associated Gas & Electric Company (D.C., S.D., N.Y., 1938) 24 Fed. Supp. 899 (Affirmed C.C.A. 2, 1938, 99 Fed.(2d) 795)..... 30
Security-First National Bank v. Earp (1942) 19 Cal.(2d) 774; 122 Pac.(2d) 900 21
Seeger v. Odell (1941) 18 Cal.(2d) 409, 414-5; 115 Pac.(2d) 977, 980-81 21
Shippen v. Bowen (1887) 122 U.S. 575, 582-3..... 25
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Stewart v. Wyoming Ranche Co. (1888) 128 U.S. 383..... 15

Pages

Tower Hill-Connelsville Coke Co. v. Piedmont Coal Co. (C.C.A. 4, 1933) 64 Fed.(2d) 817 (Cert. den. 290 U.S. 675) 13

United States v. Stewart (C.C.A. 9, 1941) 121 Fed.(2d) 705 39

U. S. v. Fifty Nine Tubes, etc. (D.C., S.D., N.Y., 1940) 32 F.S. 958, 963 24

Victor Oil Co. v. Drum (1920) 184 Cal. 226, 242-3; 193 Pac. 243, 250 38

W. P. Walker & Co. v. Walbridge (C.C.A. 5, 1905) 136 Fed. 19 (Cert. den. 199 U.S. 605) 21

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(Applicable portions in App. viii-ix) 4, 6, 29, 32
Section 2(3) (App. viii) 30
Section 3(a) subsections 9 and 10 31
Sections 5(a) and 12(l) (App. viii-ix) 29, 30
Section 19(a) (App. ix) 33, 34

General Corporation Law of Delaware, Section 61 (App. vi-viii) 23, 32

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23 *Am. Jur.* 963 22
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38 *Am. Jur.* 854 22

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45 *C. J.* 981-2 22

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In the Supreme Court of the United States

OCTOBER TERM, 1943

No._____

LELAND STANFORD JUNIOR UNIVERSITY and ELMER H. SHINE,
Petitioners,

vs.

THE NATIONAL SUPPLY COMPANY, a corporation,
Respondent.

Brief in Support of Petition for Writ of Certiorari

I.

STATEMENT OF JURISDICTION

A concise statement of the grounds on which the jurisdiction of this Court is invoked and as to the jurisdiction of the District Court is set forth in the preceding Petition for Writ of Certiorari* (p. 8), and is incorporated herein by this reference.

*Herein called the "Petition".

II.

OPINIONS BELOW

The opinion of the Circuit Court of Appeals for the Ninth Circuit is reported in 134 Fed.(2d) at pages 689-694 and appears also in the Record at pages 2986-3000. References herein to particular portions of such opinion are to the Record. The opinion of the District Court is not reported, but appears in the Record at pages 211-12.

III.

JUDGMENTS OF DISTRICT COURT AND CIRCUIT COURT OF APPEALS

The judgment of the District Court was entered July 29, 1942, and appears in the Record at pages 313-15. The judgment of the Circuit Court of Appeals was entered April 1, 1943, and appears in the Record at pages 3000-1. The petition for rehearing and for a hearing in bank was denied by the Circuit Court of Appeals on May 22, 1943 (R. 3001).

IV.

CONCISE STATEMENT OF THE CASE

The important facts for consideration of the Petition are set forth in the Petition at pages 2-7 inclusive under the heading "SUMMARY STATEMENT OF THE MATTER INVOLVED". To avoid duplication, that statement is incorporated herein by this reference as our statement of the case. Throughout this Brief we shall refer to the parties

and their predecessors by the same abbreviations as in the Petition, i.e., petitioner Leland Stanford Junior University will be called "Stanford" or "plaintiff", respondent The National Supply Company (a Pennsylvania corporation) will be called "defendant", its predecessor, The National Supply Company of Delaware, will be referred to as the "Delaware corporation" and the other predecessor of defendant, Spang, Chalfant & Co., Inc., will be called "Spang".

V.

SPECIFICATION OF ERRORS

The errors of the Circuit Court of Appeals relied upon, and intended to be urged, will be set forth herein under numbers referring to the corresponding questions presented by the Petition. The Circuit Court of Appeals erred in each of the following respects:

1. (a) In holding that Stanford's representatives were negligent in relying upon a summary of a consolidation plan sent by the directors of the Delaware corporation to Stanford as a stockholder.

(b) If such reliance was negligence, the Court erred in holding that it constituted a good defense to causes of action for deliberate and wilful frauds perpetrated by the directors—fiduciaries—against Stanford—their beneficiary.

2. (a) In holding that the failure by Stanford's representatives to investigate more fully a detailed consolidation plan established contributory negligence as a good defense to Stanford's cause of action for fraud based on the adoption of an unfair plan, when this negligence did

not contribute in any way to the adoption of the plan, but merely resulted in the loss by Stanford of one alternative remedy for such fraud, namely, the statutory appraisal right under Delaware law.

(b) In holding that the Delaware appraisal remedy was an exclusive remedy—a holding necessarily implied in the Court's decision that negligence which resulted in the loss of this remedy constituted a bar to the exercise of any other remedy, and particularly a bar to a suit for damages for the adoption of the unfair plan.

3. In holding that an exchange of securities pursuant to a consolidation plan adopted under Delaware law is not a "sale" within the registration requirements of the Federal Securities Act of 1933.

4. In setting aside important findings of fact without cause, by simply ignoring them, including the findings which contradicted the existence of plaintiff's negligence, the findings as to the wilful and deliberate character of the frauds, which rendered negligence unavailable as a defense, and the findings which negatived laches and estoppel. The ignored findings are more particularly specified in the Petition at pages 5-7 and 12-13.

5. In having plaintiff's petition for a rehearing in bank referred to and passed upon solely by the three Judges who heard the appeal in the first instance and who were less than a majority of the Circuit Court of Appeals.

VI.

SUMMARY OF ARGUMENT

1. The District Court found that both the primary fraud, consisting of the adoption of an unfair plan, and the secondary fraud, consisting of the concealment of the Delaware appraisal right and of the fact that failure to act would result in automatic conversion of plaintiff's stock, were wilful and deliberate frauds on the part of the directors of the Delaware corporation. The Circuit Court of Appeals reverses the District Court primarily by holding that plaintiff's representatives were guilty of contributory negligence in relying upon the letter sent to them by the directors instead of reading the entire plan and agreement. This holding of negligence is itself erroneous, because the District Court found that the letter appeared to be a summary of the plan and agreement and was intended by the directors so to appear and therefore Stanford, as a stockholder, was entitled to rely upon the letter. However, assuming for argument that the reliance on the letter was negligence, the holding that this is a defense to liability for an intentional wrong done by fiduciaries to their beneficiary is contrary to the local law of California, as established by California decisions, and contrary to the local law of all other states as established not only by state court decisions but by those of the United States Supreme Court and other Circuit Courts of Appeals.

2. If Stanford's reliance on the letter was negligence, it may have contributed to the secondary fraud, namely, the concealment of the appraisal right and of automatic conversion, but it did not contribute in any way to the primary fraud, because it had nothing to do with the

adoption of the unfair plan. By holding that this negligence, resulting in loss of the appraisal right, also barred one of plaintiff's alternative remedies, namely, an action at law for damages for fraud, the Circuit Court of Appeals necessarily decides that the Delaware appraisal remedy is the sole and exclusive remedy. In this it conflicts directly with an applicable Delaware decision, with a decision of the Circuit Court of Appeals for the First Circuit in which certiorari was denied by the Supreme Court, with numerous other state court decisions involving similar statutes, and even with a dictum rendered in a prior case by another group of Judges of the Ninth Circuit.

3. The offer of an exchange of stocks pursuant to the consolidation plan, as made to plaintiff in this case, required registration under the Federal Securities Act of 1933, because the term "sale" as used in that Act ordinarily includes an exchange, and there is no express exemption of an exchange pursuant to a plan adopted by stockholders and directors acting in their corporate capacities. The intention of Congress to have such an exchange included within the registration requirements is demonstrated by certain express exemptions in the Act, which would have been unnecessary if such an exchange were not included, and is also proven by the 1933 House Committee Report, which expressly stated that mergers and consolidations were not exempted by the statute. The facts in this case demonstrate that the evils against which the Act was aimed require registration just as much in the case of a consolidation as in any other promotion. Furthermore, since each stockholder here had his choice be-

tween three alternatives, individual action was required and thus any exchange which was offered would not result solely from the action of directors and stockholders in their corporate capacities.

4. Rule 52(a) of the Federal Rules of Civil Procedure requires that findings of fact be not set aside by an appellate court unless clearly erroneous. It was a violation of this rule for the Circuit Court of Appeals to set aside findings of the District Court by merely ignoring them and without any examination of the Record with respect to such findings. The findings so erroneously ignored include some of the most important findings which, if given weight, would necessarily have altered the decision on appeal. They include the findings of deliberate intent to defraud which prevented negligence from constituting a defense, the finding as to the "summary" character of the letter, which demonstrated the absence of negligence, and the findings which negatived the existence of estoppel or laches.

5. The action of the Circuit Court of Appeals in referring plaintiff's petition for a rehearing by the entire Court *in bank* solely to the three Judges—less than a majority of the Court—who heard the appeal in the first instance appears erroneous, but since this action does not affect the merits of plaintiff's case, no argument on this point is presented beyond reference to the questions on this subject raised in the preceding Petition and the suggestion that the problems involved should be passed upon by the Supreme Court.

VII.

ARGUMENT

1. THE CIRCUIT COURT OF APPEALS ERRED IN HOLDING THAT CONTRIBUTORY NEGLIGENCE, IF ESTABLISHED, IS A GOOD DEFENSE TO WILFUL AND DELIBERATE FRAUDS BY DIRECTORS AGAINST A STOCKHOLDER.

The Reversing Opinion* is so exclusively devoted to exposing oversight on the part of Stanford's representatives that it never reaches the point of analyzing the wrong-doing of the directors of the Delaware corporation, defendant's predecessor, for whose acts defendant is responsible to plaintiff Stanford. The Reversing Opinion fails to state that the frauds of such directors were intentional and deliberate, nor does it discuss whether that fact affects the availability of negligence as a defense. It is as if the Circuit Court of Appeals had considered this case analogous to one where a plaintiff suffers a personal injury in an accident caused by the unintentional negligence of defendant's agent. Actually this case is like one where defendant's agent wilfully aims a gun at plaintiff and shoots and wounds him. In such a case, of course, no amount of negligence of the plaintiff is a defense.

Magar v. Hammond (1906) 183 New York 387; 76 N.E. 474; 3 L.R.A. (N.S.) 1038.

The Findings of Deliberate Intent to Defraud.

(a) The Primary Fraud—Adoption of an Unfair Plan.

The findings of the trial court as to the character of the frauds are perfectly clear and they are not questioned

*We refer to the opinion of the Circuit Court of Appeals (R. 2986-3000) as the "Reversing Opinion".

by the Reversing Opinion. The primary fraud against plaintiff was the adoption of an unfair consolidation plan for the Delaware corporation and Spang, its subsidiary, out of which defendant emerged as the consolidated corporation and by which plaintiff was deprived of a large part of the value of its preferred stock and the unpaid arrears of dividends on such stock. As to this fraud the findings are not only that the plan was grossly unfair in result, depriving the preferred stock of more than $6,000,000 in value—between one-third and one-quarter of its total value—and transferring all this value to the common stock (R. 249-51 and R. 274); but, what is more important, the findings are that this result was deliberately designed by the directors for the wrongful purpose of benefiting the common stock, of which such directors were predominantly holders, and the largest holders. This is demonstrated by the following description of detailed findings.

On this subject the District Court found that the controlling directors were primarily large common stockholders (R. 235-7);* that the director who took the lead in financial plans (R. 239) resolved upon the purpose of extinguishing the arrears of preferred dividends

> "without paying the same in cash, by means of some form of reorganization, recapitalization or other means, and that by the same means and at the same time the dividend requirements, redemption and liquidation preferences and other preferences attached to the said 7% preferred stock should be reduced, to

*They included the two largest holders of common (R. 695).

> the end that the value of the common stock * * * would be enhanced at the expense of the holders of said 7% preferred stock, and so that the holders of said common stock would be placed in a position to receive dividends thereon" (R. 238).

It is further found that the other directors learned of this purpose and "accorded therein" (R. 238) and thereafter followed the lead of this director who first adopted such purpose (R. 239); also that consolidation was only adopted on the advice of the attorney for the Delaware corporation (who was also a director)

> "that consolidation was the only way in which the said purpose of eliminating said arrears of dividends on said preferred stock without payment in cash and of changing the preferences and rights attached to said preferred stock could be accomplished" (R. 246-7).

Numerous findings show that this intent of taking values from the preferred for the benefit of the common carried through all the planning which resulted in the final consolidation plan (R. 239-49); but these constitute mere detailed support for the further finding that in and by the formulation of the final plan,

> "the said purpose of the board of directors of eliminating the arrears of dividends upon the 7% preferred stock * * * without payment, and of reducing the preferences and other rights attached to said preferred stock, and thereby enhancing the value of the common stock * * * at the expense of the holders of said preferred stock, was fully accomplished" (R. 249-50),

subject only to approval by stockholders' vote and avoidance of too many cash demands (R. 250). In the same paragraph the District Court finds that

> "At the time the board of directors of The National Supply Company of Delaware adopted said plan on August 10, 1937, said board knew that said plan had been fixed upon for said purpose, and knew that it would have said effect" (R. 250-51).

Further detailed findings show that the directors, in the letter to stockholders which they sent out over the signature of the President, made numerous false and misleading statements in order to obtain the stockholders' approving vote and to minimize dissents (R. 251-66); but these merely furnish further proof of the wilfulness of the primary fraud and demonstrate that the vote of the stockholders was meaningless because obtained by fraud. With respect to plaintiff Stanford, which did not vote for the plan, but refused its proxy (R. 280), the more important findings are those as to the ultimate accomplishment of the directors' intent to injure its preferred stock. We quote them as follows from paragraph 41 of the findings:

> "41. The said Agreement and Joint Plan of Consolidation was decided upon, formulated and effectuated by the board of directors of The National Supply Company of Delaware as a means of cancelling the arrears of dividends upon the 7% preferred stock of said corporation without payment and of reducing the value, rights and preferences of said preferred stock, all without any or substantial equivalent therefor. Said board of directors considered that the common stockholders of said corporation would be bene-

fited by said Agreement and Joint Plan of Consolidation, by and through said elimination of arrears and reduction of the value, rights and preferences of said preferred stock. Said board of directors regarded and treated the preferred stockholders as parties having adverse interests which it was desirable to reduce and cut down. Except as last stated, the said board of directors did not consider said consolidation to be advantageous, beneficial or desirable to or for The National Supply Company of Delaware or its shareholders." (R. 275)

Most important of all is the finding that the directors' purpose was to benefit themselves:

"44. In and by the effectuation through said consolidation of their said object and purpose of enhancing the value of the common stock of The National Supply Company of Delaware at the cost and expense of the holders of the preferred stock of said corporation, the majority of the directors expected and intended that their own personal interests would be substantially and materially improved, and all the board of directors knew and expected and intended that said improvement would be accomplished at the expense of and to the loss of the holders of the said preferred stock." (R. 278)

The adoption of an unfair plan of consolidation or other unfair corporate plan by controlling directors is, of course, fraud. See the following authorities among many so holding:

Allied Chemical & Dye Corporation v. Steel & Tube Co. (1923) 14 Del.Ch. 1, 120 Atl. 486;

Federal United Corp. v. Havender (Del., 1940) 11 Atl.(2d) 331, 339-343 (dictum only);

Jones v. Missouri-Edison Electric Co. (C.C.A., 8, 1906, 1912, 1913) 144 Fed. 765; 199 Fed. 64; 203 Fed. 945; (Cert. den. 229 U.S. 615);

Outwater v. Public Service Corp. of N. J. (1928) 103 N.J.Eq. 461, 143 Atl. 729 (Aff'd 104 N.J. Eq. 490; 146 Atl. 916);

Goodisson v. North American Securities Co. (1931) 40 Ohio App. 85, 178 N.E. 29;

Boyd v. N. Y. & H. R. Co. (D.C., S.D., N.Y., 1915) 220 Fed. 174; and

Tower Hill-Connelsville Coke Co. v. Piedmont Coal Co. (C.C.A., 4, 1933) 64 Fed.(2d) 817; (Cert. den. 290 U.S. 675).

Such a plan is "constructive" fraud regardless of intent, but when directors adopt the plan to feather their own nests, as here found, there can be no doubt that it is actual fraud—wilful and deliberate fraud.

(b) The Secondary Fraud—Concealment of the Appraisal Remedy and of Automatic Conversion.

The secondary fraud aimed at Stanford was for the purpose of aiding the primary fraud and was equally intentional. It consisted of the concealment of the Delaware statutory appraisal right and the further concealment of the fact that if stockholders did nothing, they would lose this right and their old stock would be extinguished by automatic conversion into securities of the new company.

The District Court found that the right under the Delaware statute to obtain fair value pursuant to an

appraisal, including the necessity of timely objection and demand in order to avail of such right, was concealed by omission from the letter sent to stockholders, although other alternative rights were carefully explained (R. 261-2); also that the fact that the old preferred stock and accrued dividends would be extinguished by automatic conversion into securities of the new company was not only omitted, but was affirmatively concealed by the way in which the letter to stockholders was drawn (R. 260).

But more important than these findings of omissions from the letter are the findings as to the deliberate purpose of the directors in that connection. The findings as to the omissions above mentioned are all contained in subparagraphs of paragraph 32 of the findings and are preceded by the finding that

> "the Prospectus was by the said board of directors carefully drawn and prepared and the said omission of said facts† therefrom by the said board of directors was intentional and deliberate." (R. 259)

Near the end of paragraph 32 it is further found as follows:

> "and The National Supply Company of Delaware and its president and board of directors and each of them knew said facts and intentionally omitted the same from said Prospectus * * * for the purpose and with the intent of concealing said cash alternative from stockholders, and of leading stockholders into the belief that said cash alternative was not available, and into the belief that stockholders were not to be deprived of their former rights without their

†i.e. the appraisal right and automatic conversion.

> consent, and for the purpose and with the intent of avoiding as far as possible the payment of cash to stockholders, in order to accomplish said consolidation without affording stockholders notice of or a fair opportunity to exercise said right to cash payment, and of forcing said exchange upon them without their knowledge or consent." (R. 263-4)

The reason for such intent of the directors and the deliberate character of the fraud are further explained in paragraph 48 of the findings, which reads in part as follows:

> "The board of directors of The National Supply Company of Delaware desired to have as few objections and dissents as possible, in order thereby to minimize the amount of money that the defendant would have to expend in paying to dissenting stockholders the fair value of their stock, and because of said desire and in order to minimize said amount said board of directors deliberately concealed said right to payment of value in money, as more particularly set forth in paragraph 32 of these findings." (R. 281)

A misleading omission is, of course, just as much a fraud as an affirmative misstatement.

> *Stewart v. Wyoming Ranche Co.* (1888) 128 U.S. 383;
>
> *Equitable Life Insurance Co. v. Halsey, Stuart & Co.* (1941) 312 U.S. 410, 426.

In this case, therefore, there can be no doubt that both the primary and the secondary frauds were established as wilful and deliberate frauds.

The Reversing Opinion Sustains the Defense of Negligence.

The basic holding of the Reversing Opinion is that recovery by plaintiff is precluded by the negligence of plaintiff's financial analyst and investment committee of trustees. After discussing the only two cases† cited in the Reversing Opinion, neither of which involved any claim of fraud or even unfairness in result except by way of dictum, the Reversing Opinion says:

> "In this frame of reference we are obliged to consider Stanford's diligence or the lack of it. Certainly there was ample time to investigate and to pursue such inquiries as might reasonably have suggested themselves to a stockholder as persuaded of the injustice of the proposal as this one was. * * * How did the committee and its analyst employ this time and what use did they make of the literature?" (R. 2995)

The Reversing Opinion then proceeds to hold that although the letter to stockholders did not explain the automatic conversion of the stock,

> "The shareholder who had read the letter with a degree of intelligent care could not but be put on inquiry as to the fate of his existing holdings in the event of a merger. * * * Had the agreement itself been examined all rational doubt on the subject would have been set at rest. On this phase of the matter we conclude that Stanford was not lulled into a sense of security. It was merely mistaken." (R. 2996-7)

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†*Federal United Corp. v. Havender* (Del., 1940) 11 Atl.(2d) 331, and *Windhurst v. Central Leather Co.* (1927) 101 N. J. Eq. 543, 138 Atl. 772.

This is a conclusion of negligent mistake.

The Reversing Opinion treats similarly the result of the letter's failure to disclose the Delaware appraisal remedy. At R. 2997 the Reversing Opinion explains that although the letter was silent on the subject, a careful reading of the rest of the literature, particularly the "Agreement and Joint Plan of Consolidation" would have disclosed some references to the existence of this remedy—not a full explanation of its character but references sufficient to excite further inquiry as to what the remedy was and how it should be exercised. The Reversing Opinion says:

> "Had the analyst or some member of the committee been at pains to read the literature the existence of the legal right to dissent and demand payment could not well have escaped their attention." (R. 2997)

Following this passage the Reversing Opinion holds that Stanford was under a greater duty of care than the ordinary stockholder, because it realized the unfairness of the plan. It is said:

> "A stockholder who is induced by the literature sent him to believe that a proposed merger is fair, though in fact it is not, is not led to inquire as to his legal rights in the premises. * * * But not so a stockholder entertaining the views of Stanford. As a reasonable person he would want to know what provision, if any, is made by the law of the corporate domicile for taking care of the dissenter. We gather that the committee was content to forego so vital an inquiry because its members mistakenly believed that the University was entitled to keep its stock,

> consolidation or no consolidation. Thus an assumption indulged in without a reason and without inquiry induced the complacency which characterized the conduct of this stockholder throughout." (R. 2997-8)

In other words, the Circuit Court of Appeals concludes that because Stanford realized the unfairness of the plan in result, it should have been especially suspicious of the letter to stockholders and was therefore negligent in not also examining in detail the document which the letter appeared to summarize.*

All this is a decision that plaintiff failed to exercise a high degree of care. The discovery by the Circuit of Appeals of any negligence at all is factually erroneous, in view of the fact that the District Court heard in person the testimony of plaintiff's financial analyst and investment committee members, as well as the testimony of the attorney-director of the Delaware corporation who actually prepared the letter to stockholders and the other documents, and that thereafter the District Court found expressly that the letter

> "appeared to be and was, and was by the said board of directors intended to appear as and to be, and the plaintiffs believed the same to be, a statement

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*While Stanford did realize from its careful examination of the letter that the plan was unfair *in result*, it could not then know that the directors *deliberately intended* this unfairness to feather their own nests. It did not find out about this intent until the depositions were taken after the suit was pending in the court below. (Finding paragraph 53, R. 283-5.) Had Stanford known of the dishonest intent, as well as the unfair result, it might have suspected wilful fraud in the letter and might have extended its investigation.

> of the purport and effect of the Agreement and Joint Plan of Consolidation and the reasons therefor, and plaintiffs and each of them relied thereon as being a statement of the purport and effect thereof and of the reasons therefor." (R. 259)

Although the letter thus appeared to be a summary of the legal agreement and was intended by the directors so to appear,* the Circuit Court of Appeals reverses the District Court decision that plaintiff was entitled to rely on the summary as such and the appellate court holds that it was negligence for plaintiff to treat the letter as a summary† and not to read the legal document which it summarized or perhaps employ an attorney to analyze that document and advise about the Delaware law.

Such a holding of negligence will be surprising to anyone who believes that a letter authorized by the directors and signed in the name of the president of a corporation, summarizing an important corporate plan, must either state all the important facts about the plan or else explain expressly that it omits *important* matters. Conceding, however, for argument's sake, that such holding could be justified as a factual holding under all the circumstances of this case, it would be at most a decision that plaintiff did not exercise due care in failing to make a more ex-

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*This particular part of the finding is based upon allegations in plaintiff's complaint (R. 35) which were admitted in the answer (R. 162).

†The Record shows without conflict that plaintiff's financial analyst studied the letter thoroughly (R. 481-2) and relied on it as a summary of the legal agreement (R. 489); also that one member of the investment committee looked the letter over and the other member present at the meeting relied on the financial analyst's report based upon the letter (R. 420, 450, 491-3).

tensive inquiry. That is a holding of contributory negligence.

The Conclusion That Contributory Negligence Is a Defense to Wilful Fraud by Fiduciaries Is Contrary to the Local Law of California and All Other States and Conflicts with Decisions of the Supreme Court and Other Circuit Courts of Appeals.

It is when the Reversing Opinion finally concludes, without the least discussion, that the negligence so assumed by the appellate court bars plaintiff's recovery for an intentional wrong done by fiduciaries to their beneficiary, that it becomes clearly erroneous as a matter of law. In holding that negligence is a defense to a wilful fraud, even in the absence of any consideration of the fiduciary relationship, the Reversing Opinion runs directly counter to the law of California, where the frauds were consummated against plaintiff Stanford and from whose courts this case was removed. As the California Supreme Court said in a case where plaintiff likewise failed to investigate further:

> "* * * Negligence on the part of the plaintiff in failing to discover the falsity of a statement is no defense when the misrepresentation was intentional rather than negligent. (See cases cited in 12 Cal. Jur. 758, 759; Prosser, Torts, 748.) As a general rule negligence of the plaintiff is no defense to an intentional tort. (See Prosser, Torts, 402.) The fact that an investigation would have revealed the falsity of the misrepresentation will not alone bar his recovery. (Rest. Torts, sec. 540; see cases cited in 12 Cal. Jur. 758, 759) * * * Nor is a plaintiff held to the standard of precaution or of minimum knowledge of a hypothetical, reasonable man. * * * 'No rogue

> should enjoy his ill-gotten plunder for the simple reason that his victim is by chance a fool.' (Chamberlin v. Fuller, 59 Vt. 247 [9 Atl. 832, 835].) * * * The fact that an examination of the record would have revealed to plaintiffs the falsity of the representation or that they may have been negligent in failing to make further investigations does not bar their right to relief."
>
> *Seeger v. Odell* (1941) 18 Cal.(2d) 409, 414-15; 115 Pac.(2d) 977, 980-81.

To the same effect see

> *Security-First National Bank v. Earp* (1942) 19 Cal.(2d) 774; 122 Pac.(2d) 900;

and other California authorities cited in that case. The law of all other English and American jurisdictions is the same on this question. See, for example,

> *Equitable Life Insurance Co. v. Halsey etc. Co.* (1941) 312 U.S. 410;*
>
> *W. P. Walker & Co. v. Walbridge* (C.C.A., 5, 1905) 136 Fed. 19 (Cert. den. 199 U.S. 605);
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> *Martin v. Burford* (C.C.A., 9, 1910) 181 Fed. 922, 926;
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> *Directors etc. of Central Railroad Co. of Venezuela v. Kisch* (House of Lords, 1867) L.R. 2 H.L. (E.&I. App.) 99, 120-1;
>
> *Albany Savings Institution v. Burdick* (1881) 87 N.Y. 40, 49;

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*This case also involved a fraudulent omission in connection with securities and the Supreme Court held that since the fraud was intentional the plaintiff did not have to inquire further, although it could have found out if it had. The question whether negligence was a defense was argued expressly in the briefs. The case involved Iowa law.

Griffith v. Parks (1911) 165 Ill.App. 337; and
Schweyer & Co. v. Mellon (1917) 196 Mich. 590; 162 N.W. 1006.

Many similar cases are cited in 26 *C. J.* 1147-9, 45 *C. J.* 981-2, 23 *Am. Jur.* 963 and 38 *Am. Jur.* 854.

There are, of course, situations in which a plaintiff, dealing at arm's length with the defendant and having his own full means of information, is precluded from recovery because he has been negligent in *relying* on defendant's false statement. But where the defendant is a fiduciary or where, even in the absence of confidential relations, the defendant obviously has superior knowledge of the facts, it is both the law of California and of other states generally that plaintiff is not barred from recovery for intentional fraud by negligence in relying on the defendant's statement and thus failing to investigate further.

Rutherford v. Rideout Bank (1938) 11 Cal.(2d) 479, 485-6; 80 Pac.(2d) 978, 981-2;
Barron Estate Co. v. Woodruff Co. (1912) 163 Cal. 561, 574-7; 126 Pac. 351, 356-8;
Falter v. United States (C.C.A., 2, 1928) 23 Fed. (2d) 420, 424 (Cert. den. 277 U.S. 590);
Blakeslee v. Wallace (C.C.A., 6, 1930) 45 Fed. (2d) 347, 352;
Cases cited in 26 *C. J.* 1158-9 and 23 *Am. Jur.* 966-7.

Here, of course, the wilful fraud was committed by the directors of the Delaware corporation, who were both fiduciaries for the stockholders and also persons possessed of inside knowledge and legal advice as to all facts and

results of any corporate plan. Thus there can be no doubt that the Reversing Opinion errs in upholding the defense of contributory negligence, and in this respect not only conflicts with state law but also with the decision of the Supreme Court in *Equitable Life Insurance Co. v. Halsey etc. Co.,* above, and with at least the Circuit Courts of Appeals of the Second, Fifth and Sixth Circuits in the cases decided by those courts which are cited in the last two lists above.

2. **THE CIRCUIT COURT OF APPEALS ERRED IN HOLDING THAT PLAINTIFF'S NEGLIGENCE, WHICH RESULTED ONLY IN LOSS OF ITS DELAWARE APPRAISAL REMEDY, ALSO BARS PLAINTIFF'S ACTION AT LAW FOR DAMAGES.**

For argument's sake, we assume in this point, contrary to the express findings of the trial court, that plaintiff's representatives were negligent, as the appellate court holds. This assumed negligence, however, consisted of a failure to investigate and find out about the Delaware statutory right to obtain fair value through an appraisal.* It did not in any way contribute to the primary fraud, namely, the adoption by the directors of an intentionally unfair consolidation plan, which act is denominated by the law as a fraud.

Actually that act of the directors was an abuse of power by fiduciaries acting against the interests of their beneficiaries (the stockholders). In its effect upon this plaintiff it did not depend upon deception, for Stanford was not deceived, since it realized the plan was unfair in re-

*Section 61 of the General Corporation Law of Delaware quoted in the Appendix to this Brief, pages vi-viii.

sult, as the Reversing Opinion itself recognizes (R. 2989). The fraud did depend upon deception of other stockholders in order to get their vote, but the gist of the wrong done to plaintiff was the forceful deprivation of value of the preferred stock and this was like an intentionally wrongful conversion of stock or other wilful destruction of property.

The Circuit Court of Appeals seems to overlook the existence of the primary fraud. Perhaps this is because the short opinion of the District Court (R. 211-212) was devoted principally to the secondary fraud—the deceptive letter—and merely mentioned "circumstances in evidence which amounted to a breach of trust on the part of the directors and officers * * *" and that the "plan of consolidation * * * would operate to drastically alter * * * property rights" of stockholders in the old corporation (R. 211). However, regardless of the correct interpretation of the trial court's opinion, the "Findings of Fact and Conclusions of Law" subsequently made by that court (R. 225-287) described fully both the primary and secondary frauds; and, of course, it is the formal findings of fact and conclusions of law which constitute "the juridical act formalizing the court's decision."

U. S. v. Fifty-Nine Tubes, etc. (D.C., S.D., N.Y., 1940) 32 F.S. 958, 963;

American Insurance Co. v. Scheufler (C.C.A., 8, 1942) 129 Fed.(2d) 143, 146.

Stanford's representatives had nothing to do with this primary wrong—the adoption of the unfair plan—and their negligence did not contribute to it. The wrong was

entirely the work of the directors of the Delaware corporation; indeed, Stanford refused to give a proxy to vote its stock for the plan (Finding, R. 280).

What the negligence actually did was to cause Stanford to lose the Delaware statutory appraisal right, and nothing more. Thus the negligence contributed only to the secondary fraud, namely, concealment of that appraisal right.

But as for the primary fraud—the unfair plan—Stanford had other remedies equally available, including an injunction suit, an equitable or declaratory proceeding to declare the consolidation void, and an action at law for damages.* It chose this last remedy, the action at law. And it could have done so, had it known all about the alternative appraisal remedy; indeed, it could have chosen the action at law for any reason that suited it, such as, for example, its objection to having appraisers who would be subject to disqualification or appointment by a court in Delaware,† or its preference for courts over arbitration.

In holding that the failure of Stanford to find out about the Delaware statutory remedy precludes any recovery in this action, the Reversing Opinion, in effect, decides that the Delaware remedy is the sole and exclusive remedy; for surely if there were several alternative remedies equally available to a stockholder, the loss of

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*An action for money damages for fraud is an action at law. *Philpott v. Superior Court* (1934) 1 Cal.(2d) 512, 36 Pac.(2d) 635; *Shippen v. Bowen* (1887) 122 U.S. 575, 582-3; *James-Dickinson Co. v. Harry* (1927) 273 U.S. 119, 121, 126.

†See *Scott v. Arden Farms Co.* (Del. Ch., 1942) 28 Atl.(2d) 81, for some of the difficulties arising in a Delaware statutory appraisal.

one of them through negligence would not lose the others. The whole Reversing Opinion assumes that the loss of the appraisal remedy lost everything for plaintiff and thus implicitly decides that the Delaware statutory remedy was exclusive. In this it conflicts directly with an applicable Delaware decision, with a decision of the Circuit Court of Appeals for the First Circuit in which certiorari was denied by the Supreme Court, with numerous other state court decisions involving similar statutes and even with a dictum rendered in a prior case by another group of Judges of the Ninth Circuit.

The Delaware decision, above mentioned, is

> *Cole v. National Cash Credit Ass'n.* (1931) 18 Del.Ch. 47, 156 Atl. 183,

which established the law of Delaware with respect to the very merger and consolidation statutes involved in this case. The case arose from a merger, but the same statutory appraisal remedy is provided for a merger as in the case of a consolidation. On the question as to the exclusiveness of this remedy, the Delaware Court of Chancery said in the opinion, 156 Atlantic at 187:

> "* * * Furthermore, if consent to the merger be induced by fraud practiced upon a consenting company, a stockholder is under no duty to elect whether he will abide by a merger so induced or take his money. In such a case equity holds that no just alternatives are presented to him for a choice. See Bailey v. Citizens' Gas Light Co., 27 N.J.Eq. 196; Wilson v. Trenton Pass. Ry. Co., 56 N.J.Eq. 783, 40 A. 597. Where also the merger proposes illegally to wipe out a right to accumulated dividends

> on preferred stock, a court of equity will enjoin it on the application of a preferred stockholder. In such a case the stockholder's election is invited between two alternatives one of which is highly unfair. See Colgate v. U. S. Leather Co., 73 N.J.Eq. 72, 67 A. 657, reversed on other grounds, 75 N.J.Eq. 229, 72 A. 126, 19 Ann. Cas. 1262. From these and other cases which may be cited it thus appears that the election which is given to the stockholder is one that he is not, under any and all circumstances, required to exercise. The exercise of the statutory right of merger is always subject to nullification for fraud. The cases so hold."

The First Circuit case which conflicts squarely with the present decision of the Ninth Circuit is

> *May v. Midwest Refining Co.* (C.C.A., 1, 1941) 121 Fed.(2d) 431, 438 (Cert. den. 314 U.S. 668).

That case involved a sale of corporate assets rather than a merger or consolidation and the law of Maine rather than that of Delaware, but the Maine statute afforded a similar appraisal remedy without any express provision that it was exclusive and the Circuit Court of Appeals held that, in the absence of such an express provision, it was not. See particularly 121 Fed.(2d) at 438.

To the same effect are many state court decisions involving appraisal remedies in merger and consolidation statutes and in other statutes providing for important corporate acts affecting stockholders' rights. We cite the following as examples of the many decisions holding that the appraisal remedy is not exclusive:

Outwater v. Public Service Corp. of N. J. (1928) 103 N.J.Eq. 461, 143 Atl. 729;

Goodisson v. North American Securities Co. (1931) 40 Ohio App. 85, 178 N.E. 29;

Barnett v. Philadelphia Market Co. (Pa. 1907) 218 Pa. 649, 67 Atl. 912;

Langan v. Francklyn (1892) 20 N.Y.S. 404, 413-414.

Indeed, the Circuit Court of Appeals for the Ninth Circuit has itself recognized this rule, as distinguished from the principle applicable to the California statute, Civil Code Section 369(17), which expressly provides that the appraisal remedy in the case of a California corporation is exclusive. See

Beechwood Securities Corp., Inc. v. Associated Oil Co. (C.C.A., 9, 1939) 104 Fed.(2d) 537.

There the opinion by Judge Denman, concurred in by Judges Garrecht and Mathews, upheld the exclusive provision of the California statute, but carefully pointed out that statutes of other states, which did not contain this exclusive provision, did not limit the stockholder to the appraisal remedy. Thus at 104 Fed.(2d) 540, the opinion said:

> "Other states permit corporate consolidation, with the duty of the majority to offer stock in the consolidated or merged corporation, and provide for the appraisal of the shares, if the offer is not accepted, without limiting the refusing shareholder's right to a payment of the fair market value of his shares. In the absence of such a limitation of his right the courts of these states, in dicta or holdings, construe

> the statutes as giving the shareholder the right to litigate the question of fraud in the proffered exchange of his old shares for that in the consolidated corporation and equitable relief where the exercise of that right is fraudulently prevented.[2]"

The footnote "2" referred to at the end of this passage and appearing at 104 Fed. (2d) 540-541 includes the Delaware case of *Cole v. National Cash Credit Association,* above discussed, and numerous other state court cases which we have not cited, but which might well be added to the above list.

It was particularly because of the conflict between the above quoted passage from the opinion in the *Beechwood* case and the contrary decision in the instant case rendered by Judge Healy and concurred in by Judges Garrecht and Haney that we sought a rehearing by the Circuit Court of Appeals sitting ***in bank***.

3. **THE CIRCUIT COURT OF APPEALS ERRED IN HOLDING THAT THE EXCHANGE OF STOCK FOR STOCK IN A CONSOLIDATION WAS NOT A "SALE" WITHIN THE MEANING OF THE FEDERAL SECURITIES ACT OF 1933.**

The new securities issued by defendant under the consolidation plan were not registered with the Securities and Exchange Commission (R. 279), although the mails were used to offer them (R. 278-9). We contended that this constituted a violation of the Federal Securities Act of 1933 and particularly of Sections 5(a) and 12(1) of the Act.* The Circuit Court of Appeals, however, held that the exchange of securities was not a "sale" (and therefore

*Quoted in Appendix to this Brief, pages viii-ix.

the offer to exchange them was not an offering of "sale") within the definition of Section 2(3) of the Act,* which governs the terms "sale" or "sell" as used in Sections 5(a) and 12(1). We therefore address ourselves to the question whether an exchange in a consolidation is a "sale" within the meaning of the Act.

When this case was presented to the Circuit Court of Appeals, it was not denied by either defendant or the Securities and Exchange Commission (in its *amicus curiae* brief) that a voluntary exchange of stocks is ordinarily included within the term "sale" as used in the Act. Indeed, a contrary view was precluded by authorities such as

> *Securities and Exchange Commission v. Associated Gas & Electric Company* (D.C., S.D., N.Y., 1938) 24 Fed. Supp. 899 (Affirmed, C.C.A. 2, 1938, 99 Fed.(2d) 795);
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> *Indemnity Insurance Co. v. Kircher* (1934) 47 Ohio App. 140, 191 N.E. 374; and
>
> *Edward v. Ioor* (1919) 205 Mich. 617, 172 N.W. 620.

Nevertheless, it was contended that there is a difference between an exchange to which the individual stockholder's consent is necessary and one that is brought about by action of the directors and the necessary majority of stockholders acting in their corporate capacities. Defendant and the Commission must concede, however, that the distinction so sought to be drawn is not founded upon any express statutory provision and that the exemptions con-

*Quoted in Appendix to this Brief, page viii.

tained in the Securities Act show that Congress assumed that all exchanges are sales within that Act. For example, the pertinent portions of Section 3(a), subsections (9) and (10), exempt the following:

> "(9) Any security exchanged by the issuer with its existing security holders exclusively where no commission or other remuneration is paid or given directly or indirectly for soliciting such exchange;
>
> "(10) Any security which is issued in exchange for one or more bona fide outstanding securities * * * where the terms and conditions of such issuance and exchange are approved, after a hearing upon the fairness * * * by any court, or by any official or agency of the United States, or by any State or Territorial banking or insurance commission or other governmental authority expressly authorized by law to grant such approval."

These exemptions would have been unnecessary if an exchange of securities under a corporate plan did not constitute a sale. Recapitalization plans by amendment of articles, exempted by subdivision (9), are quite customarily adopted by action of directors and stockholders in corporate capacities, and reorganizations supervised by courts, exempted by subdivision (10), usually involve conversion of securities without the consent of the holder—particularly federal bankruptcy reorganizations. Why then did Congress consider it necessary to exempt them specifically?

The answer is that Congress did not intend to exempt exchanges like the one involved in this case. See the 1933 House Committee Report, which said with reference to an early draft of these exemption provisions:

> "Reorganizations carried out without such judicial supervision possess all the dangers implicit in the issuance of new securities and are, therefore, not exempt from the act. For the same reason the provision is not broad enough to include mergers or consolidations of corporations entered into without judicial supervision." [H. R. Rep. No. 85, p. 16, 73rd Congress, 1st Session, 1933.]

We urge that the principle so expressed by the House Committee is correct. The facts in this case demonstrate that the evils against which the Securities Act was aimed are quite as likely to occur in a consolidation or merger as in any other promotion.

Furthermore, since each preferred stockholder of the Delaware corporation in this case was entitled (by the plan and the Delaware law combined) to have a choice between three things, namely, 5½% convertible stock, or 6% non-convertible stock (R. 249, 261) or a money payment under the appraisal right,† it would seem clear that here the elements of voluntary offer and acceptance were present with respect to each stockholder individually. The registration provisions of the Act, therefore, applied in order to require full disclosure of this choice to the shareholders to whom the offer was made.

* * * * *

In connection with this Securities Act question, we should add that in the Circuit Court of Appeals defendant contended that if the exchange of stocks was a sale within the meaning of the Act, nevertheless the Securities and

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†If the stockholder knew the Delaware General Corporation Law, Section 61 (quoted in Appendix to this Brief, pp. vi-viii).

Exchange Commission had adopted a rule or regulation† to the effect that it was not an exchange; and that accordingly Section 19(a) of the Act‡ exempted the defendant from liability because of reliance on this regulation "notwithstanding that such rule or regulation may * * * be determined by judicial or other authority to be invalid for any reason." There are strong arguments opposed to this contention, including constitutional reasons, but we do not consider it appropriate to raise them in connection with the certiorari petition, because it does not seem to us that the possibility that Section 19(a) might exempt the defendant from liability in this particular case constitutes any answer to the suggestion that the Supreme Court should pass upon the highly important question whether an exchange in a consolidation (or other important corporate plan) adopted by vote of directors and stockholders comes within the registration requirements of the Act. Surely Section 19(a) could not contemplate that a federal court is forbidden to invalidate a regulation of the Securities and Exchange Commission merely because in the particular case before it the defendant might be exempted by Section 19(a) from actual liability on account of reliance upon such erroneous regulation prior to its invalidation. If that were the construction of Section 19(a), it would probably prevent any court from ever holding invalid any regulation of the Commission, since the defendant would always be protected by reliance on the wrongful regulation. Obviously the statute contem-

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†The Commission's Note to Rule 5(2) of the instructions as to Form E-1.

‡Quoted in the Appendix to this Brief, p. ix.

plates that when such a regulation is attacked as erroneous, the courts in the first case in which it is attacked must decide whether or not it is invalid, before going on to decide whether Section 19(a) can afford an exemption.

Here the highly important Federal question, on which the Supreme Court has not passed and on which the Circuit Court of Appeals has rendered such an unsatisfactory opinion (referring for its reasons solely to an unreported *amicus curiae* brief), is the question whether an exchange of securities in a consolidation, merger or other important corporate plan is a sale under the Securities Act. We urge that this question should be decided by the Supreme Court, and if the Court holds that such an exchange is a sale under the Act, then any erroneous regulation of the Commission will be overthrown as to the future, regardless of whether or not it may survive long enough to be a defense in any particular case which has arisen prior to such holding.

4. **THE CIRCUIT COURT OF APPEALS SO COMPLETELY IGNORES IMPORTANT FINDINGS OF THE DISTRICT COURT AS TO SET ASIDE SUCH FINDINGS WITHOUT CAUSE AND CONTRARY TO RULE 52(a) OF THE FEDERAL RULES OF CIVIL PROCEDURE.**

Nowhere does the Reversing Opinion question any finding for lack of supporting evidence or as contrary to the evidence or for any other cause. Instead, it disposes of the findings opposed to its theories by ignoring them. This is error under the provision of Rule 52(a) of the Federal Rules of Civil Procedure that:

> "Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witness."

(a) Findings of Deliberate Intent to Defraud.

As we have demonstrated by quotations above, all the findings of deliberate intent to defraud for the financial benefit of the directors are overlooked in the Reversing Opinion. This may explain how the Court fell into the error of sustaining negligence as a defense to a wilful fraud. (See pages 9-15, above, where such findings are summarized and quoted).

(b) The Finding Which Negatives Negligence.

The very holding of negligence, namely, that plaintiff's representatives were negligent in relying on the letter, instead of reading the plan and agreement, ignores the finding of the District Court, quoted above on pages 18-19, that the letter appeared to be a summary of the plan and agreement and was intended by the directors so to appear. Although this finding is impregnably fortified by an admission of the same fact in the pleadings (R. 35, R. 162), the only notice the Circuit Court of Appeals takes of such *admitted fact* is to refer to it as merely an argument, saying near the beginning of the Reversing Opinion:

> "* * * it being *contended* that this letter was a purported summary upon which stockholders were entitled to rely without further inquiry." (R. 2991; emphasis supplied).

From then on the Reversing Opinion never refers again to the character of the letter as a summary of the legal

agreement, but treats it as just another document on the same level as the legal agreement, thus holding that plaintiff's representatives were not entitled to rely upon the letter alone. In this way the holding of negligence is based upon disregard of the one basic fact—an admitted fact—which negatives negligence.

(c) Numerous Findings Which Completely Answer Claims of Estoppel or Laches.

In our Statement of the Matter in the Petition we have shown the complete disregard of findings and evidence which led the Circuit Court of Appeals to mention estoppel and laches as makeweight defenses.* We adopt that showing by reference here. However, we want to explain in greater detail two of the examples there listed.

The first is the completely unsupported assertion in the Reversing Opinion that plaintiff Stanford accepted dividends on the new stock (R. 2989). If this had been true, it might have helped to justify the defense of laches. It is noteworthy that the headnote to the report of the Reversing Opinion in 134 Fed.(2d) at page 689 seizes upon this alleged circumstance as the chief ground for laches and estoppel, saying (headnote 3):

> "Where holder of preferred shares in Delaware corporation was fully advised of proposed consolidation as provided by statute and promptly advised that consolidation had become effective, *but stockholder accepted two quarterly dividends from new corporation* and made no objection until more than six months after effective date of consolidation, ac-

*Petition, pages 6-7.

tion for cash value of shares was barred by 'laches' and 'estoppel'." (Emphasis supplied)

However, the asserted acceptance of the dividends by Stanford was not true. On the basis of uncontradicted testimony the District Court found as follows:

> "The first two dividend checks which were mailed by defendant to plaintiff Shine after the effectuation of said consolidation plan were received and cashed by plaintiff Shine as nominee of the depositary Wells Fargo Bank & Union Trust Co. without knowledge that said dividends related to the stock of the defendant into which the stock of plaintiffs had by said consolidation plan been converted, and plaintiff Stanford University and the Board of Trustees thereof first discovered that said dividends pertained to stock of the defendant in April, 1938, and immediately upon making such discovery tendered the amount thereof, with full interest thereon at the legal rate, to defendant. Plaintiffs have refused to accept all subsequent dividends thereon." (R. 282)

The other important example of the complete disregard of findings in the Reversing Opinion is the failure to note that the delay of plaintiff in bringing suit—a "mere" delay for seven months at the most*—did not prejudice defendant or its predecessors and therefore could not have constituted either laches or estoppel. The District Court made the following finding, which is never mentioned by the Circuit Court of Appeals:

> "If plaintiffs had learned the true facts with reference to said consolidation at the earliest possible time and had filed said action and done each and all of said

*See Petition, page 6, footnote *.

> acts and things done by them at the earliest possible time neither said board of directors nor said constituent companies nor any one or more of them would have done any act or thing with reference to said consolidation other or different from what they did, except only that the defendant might long since have paid plaintiffs the value of the said 1300 shares of 7% preferred stock belonging to the plaintiffs for recovery of which value this suit was brought." (R. 283)

This finding that the adoption and carrying out of the plan would not have been changed or affected in any way, if plaintiff had acted at the earliest possible time, is based upon the express testimony to that effect of the President of both the Delaware corporation and defendant (R. 1084-93), so that it must be unimpeachable as against defendant. Such finding completely eliminates both laches and estoppel, because it proves there was no injury to defendant from any delay of plaintiff, and neither of these defenses can arise from mere delay for less than the statutory period of limitations, unless the defendant has been *prejudiced* by plaintiff's failure to act.

> *London & San Francisco Bank v. Dexter Horton & Co.* (C.C.A., 9, 1903) 126 Fed. 593, 601-2 (Cert. den. 194 U.S. 631);
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> *Northern Pac. Ry. v. Boyd* (1913) 228 U.S. 482, 508-10 (affirming 177 Fed. 804, C.C.A., 9, 1910; see 177 Fed. 822-4);
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> *Russell v. Todd* (1940) 309 U.S. 280, 287;
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> *Victor Oil Co. v. Drum* (1920) 184 Cal. 226, 242-3; 193 Pac. 243, 250;
>
> *Fry v. Board of Education* (1941) 17 Cal.(2d) 753, 761; 112 Pac.(2d) 229, 234-5.

In addition, it seems to us that the Circuit Court of Appeals was misled into accepting as a bona fide defense something which was laid as a trap for plaintiff and other stockholders. The Record shows that the Delaware corporation's attorney and director, who drew all the consolidation papers, wrote to the Secretary-Treasurer on March 28, 1938, with reference to a proposed "follow-up" letter to stockholders about exchanging their old stock certificates for the new securities as follows:

> "It would be my judgment to wait from three to six months longer. Such a letter might stir up the stockholders to present claims, and the longer they *delay* presenting claims the more apt the court will be to throw them out on the ground of laches without going into the question of merits." (R. 1537)

Regardless of this, however, we submit that the ignoring of so many important trial court findings by the Circuit Court of Appeals calls for exercise of the Supreme Court's power of supervision—calls for an instruction from the Supreme Court directing the Circuit Court of Appeals to cease the disregard of District Court findings.*

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*See *Stewart v. United States* (1942) 316 U.S. 354, in which the Supreme Court, after granting certiorari, reversed *United States v. Stewart* (C.C.A. 9, 1941) 121 Fed.(2d) 705, for the same kind of failure to give weight to a trial court finding.

5. THE CIRCUIT COURT OF APPEALS ERRED IN HAVING PLAINTIFF'S PETITION FOR A REHEARING BY THE ENTIRE COURT IN BANK PASSED UPON SOLELY BY THE THREE JUDGES WHO DECIDED THE CASE IN THE FIRST INSTANCE, CONSTITUTING LESS THAN A MAJORITY OF THE APPELLATE COURT.

It seems to us that the Circuit Court of Appeals must have erred and must be continually erring in its practice of treating a petition for a rehearing in bank as if it were only an ordinary petition for rehearing, to be passed upon by the same Judges who decided the case in the first instance. This practice seems particularly questionable in a case like this, where there is a conflict with a prior opinion of a different group of Judges of the same Court; and it would seem a doubtful practice in any case involving so many conflicts with established principles and with opinions of the United States Supreme Court, other Circuit Courts of Appeals and state appellate courts.

However, this question of practice does not affect the merits of our case and therefore we do not propose to present arguments as to the error in any more detail than that in which they have already been indicated in the Petition (pages 13-15). We believe that there is involved a problem of appellate procedure which is of importance to the Federal bench and bar and, in our view, should be passed upon by the Supreme Court. But it is only an incidental question in our client's cause and we prefer to confine our argumentation to the merits of that cause. We refer again to the serious injustices accomplished by

the decision of the Circuit Court of Appeals on the merits, as explained above in the Petition and this Brief.

Petitioners urge that a writ of certiorari be granted.

Respectfully submitted,

JOHN T. PIGOTT,
Attorney for Petitioners.

HENRY D. COSTIGAN,
MORRIS M. DOYLE,
McCUTCHEN, THOMAS, MATTHEW, GRIFFITHS & GREENE,
Of Counsel.

Dated: San Francisco, California, August 2, 1943.

(APPENDIX FOLLOWS.)

Appendix

APPLICABLE PROVISIONS OF GENERAL CORPORATION LAW OF DELAWARE WITH REFERENCE TO CONSOLIDATION

(Sections 59, 60 and 61 of Chapter 65, Revised Code of 1935, as in effect in 1937.)

"Sec. 59. *Consolidation or Merger; Proceedings for:* Any two or more corporations organized under the provisions of this Chapter, or existing under the laws of this State, for the purpose of carrying on any kind of business, may consolidate or merge into a single corporation which may be any one of said constituent corporations or a new corporation to be formed by means of such consolidation or merger as shall be specified in the agreement hereinafter required; the directors, or a majority of them, of such corporations as desire to consolidate or merge, may enter into an agreement signed by them and under the corporate seals of the respective corporations, prescribing the terms and conditions of consolidation or merger, the mode of carrying the same into effect, and stating such other facts required or permitted by the provisions of this Chapter to be set out in Certificates of Incorporation, as can be stated in the case of a consolidation or merger, stated in such altered form as the circumstances of the case require, as well as the manner of converting the shares of each of the constituent corporations into shares of the consolidated corporation, with such other details and provisions as are deemed necessary.

"Said agreement shall be submitted to the stockholders of each constituent corporation, at a meeting thereof,

called separately for the purpose of taking the same into consideration; of the time, place and object of which meeting due notice shall be given by publication at least once a week for four successive weeks in one or more newspapers published in the county wherein each such corporation either has its principal office or conducts its business, and a copy of such notice shall be mailed to the last known postoffice address of each stockholder of each such corporation, at least twenty days prior to the date of such meeting, and at said meeting said agreement shall be considered and a vote by ballot, in person or by proxy, taken for the adoption or rejection of the same, each share entitling the holder thereof to one vote; and if the votes of stockholders of each such corporation representing two-thirds of the total number of shares of its capital stock shall be for the adoption of the said agreement, then that fact shall be certified on said agreement by the Secretary of each such corporation, under the seal thereof; and the agreement so adopted and certified shall be signed by the President and Secretary of each of such corporations under the corporate seals thereof and acknowledged by the President of each of such corporations before any officer authorized by the laws of this State to take acknowledgments of deeds to be the respective act, deed and agreement of each of said corporations and the agreement so certified and acknowledged shall be filed in the office of the Secretary of State, and shall thence be taken and deemed to be the agreement and act of consolidation or merger of the said corporations; and a copy of said agreement and act of consolidation or merger, duly certified by the Secretary of State under the seal of his office, shall

also be recorded in the offices of the Recorders of the Counties of this State in which the respective corporations so consolidating or merging shall have their original Certificates of Incorporation recorded, or if any of the corporations shall have been specially created by a public Act of the Legislature, then said agreement shall be recorded in the county where such corporation shall have had its principal place of business, and such record, or a certified copy thereof, shall be evidence of the agreement and act of consolidation or merger of said corporations, and of the observance and performance of all acts and conditions necessary to have been observed and performed precedent to such consolidation or merger.

"Any one or more corporations organized under the provisions of this Chapter, or existing under the laws of this State, may consolidate or merge with one or more other corporations organized under the laws of any other State or States of the United States of America, if the laws under which said other corporation or corporations are formed shall permit such consolidation or merger. The constituent corporations may merge into a single corporation, which may be any one of said constituent corporations, or they may consolidate to form a new corporation, which may be a corporation of the State of incorporation of any one of said constituent corporations as shall be specified in the agreement hereinafter required. All the constituent corporations shall enter into an agreement in writing which shall prescribe the terms and conditions of the consolidation or merger, the mode of carrying the same into effect, the manner of converting the shares of each of said constituent corporations into shares

of the corporation resulting from or surviving such consolidation or merger and such other details and provisions as shall be deemed necessary or proper. There shall also be set forth in said agreement such other facts as shall then be required to be set forth in certificates of incorporation by the Laws of the State, which are stated in said agreement to be the laws that shall govern said resulting or surviving corporation and that can be stated in the case of a consolidation or merger. Said agreement shall be authorized, adopted, approved, signed and acknowledged by each of said constituent corporations in accordance with the laws under which it is formed and, in the case of a Delaware corporation, in the manner provided in the two immediately preceding paragraphs. The agreement so authorized, adopted, approved, signed and acknowledged shall be filed in the office of the Secretary of State and said agreement shall thenceforth be taken and deemed to be the agreement and act of consolidation or merger of said constituent corporations for all purposes of the laws of this State. A copy of said agreement, duly certified by the Secretary of State under the seal of his office, shall also be recorded as provided in this Section with respect to the consolidation or merger of corporations of this State.

"If the corporation resulting or surviving such consolidation or merger is to be governed by the Laws of any State other than the laws of this State, it shall agree that it may be served with process in this State in any proceeding for enforcement of any obligation of any constituent corporation of this State, including any amount fixed by appraisers pursuant to the provisions of Section 61 of

this Chapter, and shall irrevocably appoint the Secretary of State as its agent to accept service of process in an action for the enforcement of payment of any such obligation or any amount fixed by appraisers as aforesaid and shall specify the address to which a copy of such process shall be mailed by the Secretary of State. Service of such process shall be made by personally delivering to and leaving with the Secretary of State duplicate copies of such process. The Secretary of State shall forthwith send by registered mail one of such copies to such resulting or surviving corporation at its address so specified, unless such resulting or surviving corporation shall thereafter have designated in writing to the Secretary of State a different address for such purpose, in which case it shall be mailed to the last address so designated."

"Sec. 60. *Consolidation or Merger; Status of Old and New Corporations:* When an agreement shall have been signed, acknowledged, filed and recorded, as in the preceding Section is required, for all purposes of the laws of this State the separate existence of all the constituent corporations, parties to said agreement, or of all such constituent corporations except the one into which the other or others of such constituent corporations have been merged, as the case may be, shall cease and the constituent corporation shall become a new corporation, or be merged into one of such corporations, as the case may be, in accordance with the provisions of said agreement, possessing all the rights, privileges, powers and franchises as well of a public as of a private nature, and being subject to all the restrictions, disabilities and duties of each of such corporations so consolidated or merged, and all

and singular, the rights, privileges, powers and franchises of each of said corporations, and all property, real, personal and mixed, and all debts due to any of said constituent corporations on whatever account, as well for stock subscriptions as all other things in action or belonging to each of such corporations shall be vested in the corporation resulting from or surviving such consolidation or merger; and all property, rights, privileges, powers and franchises, and all and every other interest shall be thereafter as effectually the property of the resulting or surviving corporation as they were of the several and respective constituent corporations, and the title to any real estate whether vested by deed or otherwise, under the laws of this State, vested in any such constituent corporations, shall not revert or be in any way impaired by reason of this Chapter; provided, however, that all rights of creditors and all liens upon any property of said constituent corporations shall be preserved unimpaired, and all debts, liabilities and duties of the respective constituent corporations shall thenceforth attach to said resulting or surviving corporation, and may be enforced against it to the same extent as if said debts, liabilities and duties had been incurred or contracted by it."

"Sec. 61. *Consolidation or Merger; Payment for Stock of Dissatisfied Stockholder:* If any stockholder in any corporation of this State consolidating or merging as aforesaid, who objected thereto in writing,* shall within twenty

*It is settled that the stockholder's written objection required by this provision for exercise of the appraisal right must be made before the vote for the plan at the stockholders' meeting. *Stephenson v. Commonwealth & Southern Corporation* (Del. Sup. Ct., 1933) 19 Del. Ch. 447; 168 Atl. 211.

days after the date on which the agreement of consolidation or merger has been filed and recorded, as aforesaid, demand in writing from the corporation resulting from or surviving such consolidation or merger, payment of his stock, such resulting or surviving corporation shall, within three months thereafter, pay to him the value of his stock at said date, exclusive of any element of value arising from the expectation or accomplishment of such consolidation or merger. If within thirty days after the date of such written demand the corporation and such stockholder fail to come to an agreement as to such value of such stock, such stockholder may demand an appraisal of his stock by three disinterested persons, one of whom shall be designated by the stockholder, one by the directors of the resulting or surviving corporation and the other by the two designated as aforesaid and may serve written notice on such corporation designating therein one appraiser and requiring the corporation to designate a second appraiser within thirty days from the date of service of such notice. If within thirty days from the date of service of such notice the corporation shall have failed to designate a second appraiser or if the two appraisers first designated shall fail to designate a third appraiser within thirty days from the designation of the second appraiser, such stockholder may apply to the Chancellor to designate a second and a third appraiser, or a third appraiser, as the case may be. The decision of the appraisers as to such value of such stock shall be final and binding upon the corporation and such stockholder. In case the value of such stock as so fixed by the appraisers is not paid to such stockholder within sixty days from the date of such deci-

sion and of notice thereof given to the corporation, the decision of the appraisers shall be evidence of the amount due from the corporation, and such amount may be collected as other debts are by law collectible from the resulting or surviving corporation. Upon receipt of payment in full of the value of such stock, such stockholder shall transfer his stock to the said resulting or surviving corporation, to be disposed of by the directors thereof, or to be retained for the benefit of the remaining stockholders."

APPLICABLE PROVISIONS OF THE SECURITIES ACT OF 1933, AS AMENDED

(48 Stat. 74, as amended; 15 U. S. C., Sec. 77a et seq.).

"Sec. 2. When used in this title, unless the context otherwise requires—

* * * * * * *

"(3) The term 'sale', 'sell', 'offer to sell', or 'offer for sale' shall include every contract of sale or disposition of, attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value; except that such terms shall not include preliminary negotiations or agreements between an issuer and any underwriter. * * *"

"Sec. 5. (a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell or offer to buy such

security through the use or medium of any prospectus or otherwise; or

(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

* * * * * * *"

"Sec. 12. Any person who—

(1) sells a security in violation of section 5, or

(2) * * *

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security or for damages if he no longer owns the security."

"Sec. 19. (a) * * * No provision of this title imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule or regulation of the Commission, notwithstanding that such rule or regulation may, after such act or omission, be amended or rescinded or be determined by judicial or other authority to be invalid for any reason."

(6)

FILED
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CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1943

No. 250

LELAND STANFORD JUNIOR UNIVERSITY and ELMER H. SHINE,
Petitioners,

vs.

THE NATIONAL SUPPLY COMPANY, a corporation,
Respondent.

BRIEF FOR RESPONDENT

ALLEN L. CHICKERING,
WALTER C. FOX, JR.,
VINCENT I. COMPAGNO,
111 Sutter Street,
San Francisco, California,
Attorneys for Respondent.

CHICKERING & GREGORY
111 Sutter Street,
San Francisco, California,
Of Counsel.

PARKER PRINTING COMPANY, 545 SANSOME STREET, SAN FRANCISCO

Subject Index

	Page
I. Opinions Below	1
II. Statement of Basis of Jurisdiction	2
III. Argument	2
1. The Claim of Fraud	3
2. The Federal Securities Act of 1933	11
3. The Petition for Rehearing in Bank	14
Appendix	i

Table of Authorities Cited

Pages

CASES CITED

Brown v. County of Buena Vista, 95 U.S. 157 9

Hayward v. National Bank, 96 U.S. 611, 618 ..... 9, 11

Penn Mutual Life Insurance Co. v. Austin, 168 U.S. 685 9

STATUTES CITED

Federal Securities Act of 1933, Section 19(a) 13

Judicial Code:

Section 24(1) (U.S.C.A., Title 28, Section 41(1)) 2
Section 28 (U.S.C.A., Title 28, Section 71) 2
Section 128(a) (U.S.C.A., Title 28, Section 225, subd. (a)) 2
Section 240(a) (U.S.C.A., Title 28, Section 347(a)) 2

OTHER AUTHORITIES CITED

Federal Rules of Civil Procedure, Rule 52(a) 10

Securities and Exchange Commission's Note to Rule 5(2) 11

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THE NATIONAL SUPPLY COMPANY, a corporation,

Respondent.

BRIEF FOR RESPONDENT

I.

OPINIONS BELOW

The opinion of the Circuit Court of Appeals for the Ninth Circuit is reported in 134 Fed.(2d) at pages 689-694 and appears also in the Record at pages 2986-3000. References herein to particular portions of such opinion are to the Record. The opinion of the District Court is not reported, but appears in the Record at pages 211-12.

II.

STATEMENT OF BASIS OF JURISDICTION

Petitioner invokes the jurisdiction of this Court under Section 240(a) of the Judicial Code, U.S.C.A., Title 28, Section 347(a).

Respondent invoked the jurisdiction of the District Court under Section 24(1) of the Judicial Code, U.S.C.A., Title 28, Section 41(1) pursuant to appropriate proceedings for removal from the state court because of diversity of citizenship under Section 28 of the Judicial Code, U.S.C.A., Title 28, Section 71.

Respondent invoked the jurisdiction of the Circuit Court of Appeals for the Ninth Circuit under Section 128(a) of the Judicial Code, U.S.C.A., Title 28, Section 225, subd. (a).

III.

ARGUMENT

Petitioner in effect asks for certiorari upon three grounds, to-wit: (1) The claim that the United States Circuit Court of Appeals did not give due consideration to claimed fraud of The National Supply Company of Delaware, one of the predecessors of respondent (hereinafter called the "Delaware corporation"), (2) the claim that the Delaware corporation violated the Federal Securities Act of 1933, and (3) the claim that petitioner was entitled to a hearing *in bank* by the United States Circuit Court of Appeals. The decision of the United States Circuit Court of Appeals was clearly right. In any event, no question

of public interest justifying review by this Court on certiorari is presented.

1. The Claim of Fraud.

The court dealt with both grounds advanced by the petitioner.

(1) The claim that the literature did not disclose that dissenting stockholders had a statutory right of appraisal is the only ground that was considered in the opinion of the District Court. The Circuit Court of Appeals disposed of this ground first by pointing out that the terms of the statute were incorporated as part of the corporate contract of which the stockholders must be deemed to have had knowledge. Then it went further and demonstrated in detail that the literature sent to the stockholders called attention to the statutory right not less than four times. Hence if the petitioner did not see these references, that was due to its own failure to read the literature rather than to any defect in the literature. The petitioner made the subsidiary claim that it was not advised that it could not keep its 7% preferred stock; but that claim, also, was disposed of as baseless by the Circuit Court of Appeals by detailed references to the literature.

(2) The claim that the plan was so unfair as to amount to a constructive fraud was outlined by the court but it found that it did not have to pass thereon because of its holding that the petitioner could no longer raise that question due to its laches. (However it is fairly inferable from the court's opinion that if it had believed it relevant to pass upon the fairness of the plan it would have found against the petitioner's contentions.) The opinion shows

clearly that the Circuit Court of Appeals paid full heed to the findings of the District Court but, after its own painstaking examination of the evidence, arrived at its own conclusions as to the facts, as it was authorized to do in a case in equity.

There was more than ample evidence of laches. There was no evidence to the contrary. Most of the circumstances showing laches are discussed in the opinion. It is unnecessary to quote therefrom. We confine ourselves to a listing of the elements (including those shown in the opinion) which establish beyond any doubt that laches existed.

(a) The notice of the stockholders' meeting of the Delaware corporation, together with the complete consolidation literature, was mailed to petitioner on August 10, 1937 (R. 664). The meeting was not to be held until October 11, 1937 (R. 72). The notice was given approximately sixty days in advance of the meeting, while the Delaware statute required only twenty days. Thus petitioner was given more than ample notice of what was to take place.

(b) On September 27, 1937, after an earlier meeting (at which no quorum was present), petitioner's investment committee (consisting of three prominent San Francisco business men (R. 443; 445; 461)) and petitioner's experienced paid analyst (R. 512-516) met and gave some consideration to the consolidation proposal (R. 490). The committee came to the conclusion that the Plan was grossly unfair; in fact, according to the testimony of one of the committee: "It looks crooked to me." (R. 450)

This conclusion was drawn approximately two weeks prior to the meeting. Thus petitioner was not lulled into any sense of security.

(c) Petitioner did not communicate with the Delaware corporation prior to the meeting, took no part in and was not even represented at the meeting (R. 686; 669), and did not communicate with respondent until some time thereafter (R. 686). Thus petitioner allowed the consolidation to become effective without any registered complaint.

(d) At the meeting, to-wit, on October 11, 1937, the stock of the Delaware corporation voted as follows: Of the 166,353 shares of 7% Preferred Stock outstanding, 116,564 shares, or approximately 70%, were voted in favor of the consolidation, and only 255 shares against it. The vote of the Common Stock was approximately 66.5% in favor of the consolidation, with only a few hundred shares opposing it (R. 114; 667). The vote of the Preferred stockholders was proportionately greater than that of the Common stockholders. Thus the other Preferred stockholders must have overwhelmingly favored the consolidation.

(e) The consolidation became effective on October 23, 1937, and all stockholders, including petitioner, were immediately notified (R. 497). On November 29, 1937, petitioner for the first time communicated with either the Delaware corporation or respondent (R. 686). On that date petitioner's analyst wrote the respondent, in effect, that petitioner was anxious to obtain more information before assenting to the Plan (R. 188). The analyst's letter

was disingenuous and could just as well have been written prior to the meeting, and no doubt, if written at that time, would have been followed by an appropriate answer. When it was at last written, the respondent corporation immediately replied that petitioner's right to dissent had ceased and that petitioner was bound by the consolidation (R. 687; 190). Thus for a period extending from approximately August 10 to November 29, 1937, three and one half months, petitioner still did nothing.

(f) In the meantime, in October of 1937, the new securities of the respondent corporation were listed upon the New York Stock Exchange, and thereafter freely dealt in. Transactions ran as high as several hundred shares daily (R. 952-994). Thus, the public became involved.

(g) Also in the fall of 1937 the New York Stock Market commenced to drop and continued to drop for some time thereafter (R. 1456). Thus, conditions were changing.

(h) In the meantime petitioner received and cashed and retained until the end of April, 1938, without tendering back, the proceeds of four checks for the payment of dividends upon respondent's new securities (R. 1716). A dividend check for the 5½% Preferred Stock was received in December of 1937 (R. 576). An additional check for the dividend on this stock was received in April of 1938 (R. 575). Each of these dividend checks was accompanied by a check for the dividend on the $2.00 Preference Stock (R. 577; 594). Counsel attempt to argue that these dividend checks were received by petitioner in the belief that they represented dividends upon the old 7% Preferred Stock of the Delaware corporation, and that just as soon as petitioner discovered the contrary it tendered back

the amounts represented thereby. The fallacy is apparent. A dividend upon the old 7% Preferred Stock would have been in one check, not in two checks. In addition thereto, on the old securities respondent's dividend would have been 7% or $2275. On the new securities the combined dividend amounted to 7½% or $2437.50. Thus, petitioner was either paying no attention whatsoever to its holdings or was speculating.

(i) Petitioner did not commence suit until May 11, 1938 (R. 146). This was nine months after its first notice of the consolidation.

The Circuit Court of Appeals took very great pains to examine the literature sent to the stockholders of the Delaware corporation. There were, probably, two reasons: The first reason was that the opinion of the District Court (R. 211) was based solely upon the conclusion that the Delaware corporation did not inform petitioner of its rights to object to the consolidation at or prior to the stockholders' meeting and to obtain the value of its holdings in cash.* The second reason no doubt was that the Circuit Court of Appeals desired to show that there was nothing in this literature which would in any way detract from its conclusion that laches existed. The Circuit Court of Appeals demonstrated (R. 2995-2998) that the literature would have shown to any reasonable person reading the same that the right to object and obtain the value of the shares existed. The Circuit Court of Appeals furthermore demonstrated that the literature was clear as to any further element

*It is true that elaborate findings were prepared. These findings were the work of petitioner's counsel.

that could possibly have been material to petitioner. Petitioner did not read the literature.

In the light of the foregoing we briefly dispose of counsel's arguments.

(a) Counsel claim that even though petitioner may have been guilty of negligence, the Delaware corporation was guilty of an intentional wrong and that negligence is no defense to a suit based upon an intentional wrong. They argue from the law of personal injuries. Their argument is entirely foreign. We are dealing with none other than laches. Counsel have cited no cases that the doctrine of laches cannot be applied to actions based upon intentional wrongs. Counsel forget that the rights of other stockholders were at the time of the stockholders' meeting and ever since that time have been involved. These were not only stockholders who held stock in the Delaware corporation at the time of the consolidation, but also those who bought stock in respondent since the consolidation. Petitioner certainly cannot impugn the honesty of these stockholders.

As pointed out in the opinion of the court (R. 2992), the stockholders of the Delaware corporation were entitled to rely on the status of things as they appeared at the meeting and in their voting to govern themselves accordingly. They had a right to be advised of the number of shares objecting to the consolidation, since these objections foreshadowed money demands to be made upon the new company. Furthermore, the court emphasized (R. 2993) a matter of greater importance, and that was that the public, in acquiring securities of this

respondent, were entitled to know the exact situation and should not be prejudiced by objections belatedly asserted.

In other words, the rights of third parties intervened and, no longer, was it a case, if it ever had been, between merely the petitioner and the officers and directors of the Delaware corporation. When the rights of third parties intervene, or conditions change, the doctrine of laches should be freely applied.

Hayward v. National Bank, 96 U.S. 611;
Brown v. County of Buena Vista, 95 U.S. 157;
Penn Mutual Life Insurance Co. v. Austin, 168 U.S. 685.

(b) Counsel claim that even though petitioner may have been negligent in failing to read the literature, that particular negligence could only have contributed to the loss of the right of appraisal under the Delaware statute, and could not have contributed to the claimed unfairness and claimed fraudulent nature of the consolidation plan. What we have said under (a) above is an answer. The question is one of laches. We need go no further, except to comment that counsel claim the court must have held that the right of appraisal under Delaware law was the only right that petitioner had. It was not only unnecessary for the court to so hold, but the court expressly states to the contrary. It states (R. 2993): "It may be conceded that these considerations do not in all circumstances require that a dissatisfied stockholder be denied relief if he has failed seasonably to dissent."

(c) Counsel claim that the Circuit Court of Appeals erred in not passing upon the fairness or unfairness of

the plan. As heretofore stated, inasmuch as the court found that the petitioner was barred by its laches from raising the claim of unfairness, it necessarily had no occasion to go into the claim. But one cannot read the opinion of the court without feeling that the court was out of sympathy with the petitioner's contention and that it would have rejected petitioner's claim had a decision on the point been necessary.

(d) Counsel argue that the Circuit Court of Appeals violated Rule 52(a) of the Federal Rules of Civil Procedure, since it was met by the findings and entirely ignored them. The answer is that the elements upon which the court relied are absolutely uncontradicted in the record. There are no elements having to do with the defense of laches which are to the contrary. The decision is based upon the literature, uncontradicted testimony, admissions and stipulations.

The reason for the existence of this litigation finds echo in the court's opinion, where the court states that a stockholder "may not by inaction speculate upon the outcome of the merger." (R. 2993) There was plenty of support for this view, as shown by the opinion. In addition, the minutes of petitioner's own investment committee contained the following rather startling language:

> "It was understood that they (McCutchen, Olney, Mannon and Greene) contemplated entering a suit to establish the University's position and then wait until such time as the recoverable value could be more nearly ascertained before proceeding further." (Underscoring ours.) (R. 508-509)

The language of Mr. Justice Harlan, in the case of *Hayward v. National Bank,* 96 U.S. 611, at 618, and the quotation therein contained, is very much in point:

> "The question of acquiescence or delay may often be controlled by the nature of the property which is the subject of litigation. 'A delay which might have been of no consequence in an ordinary case, may be amply sufficient to bar relief when the property is of a speculative character, or is subject to contingencies, or where the rights and liabilities of others have been in the mean time varied. If the property is of a speculative or precarious nature, it is the duty of a man complaining of fraud to put forward his complaint at the earliest possible time. He cannot be allowed to remain passive, prepared to affirm the transaction if the concern should prosper, or to repudiate it if that should prove to his advantage.' Kerr, Mistake and Fraud (Bump's ed.), pp. 302, 306." (Underscoring ours.)

It will be recalled that respondent's new securities had been listed on the New York Stock Exchange in October of 1937. Constant fluctuations followed (R. 952-994). The truth of the matter is that the petitioner was speculating.

2. The Federal Securities Act of 1933.

Respondent's position in this case has always been and is entirely consistent with the position taken by the Securities and Exchange Commission. The Securities and Exchange Commission promulgated its Rule 5(2) to its Form E-1. The note to this Rule is of importance

so we set it out *in toto* in the Appendix to this brief. It accords with respondent's position.

The Commission, also, caused to be filed, not only in the District Court but in the Circuit Court of Appeals, a brief as *amicus curiae* in support of its and our position. The Commission first argued that there was no sale, within the meaning of the Act, involved. A part of its argument in support of its and our position, as set forth in its brief before the Circuit Court of Appeals, was as follows:

> "In such consolidations and mergers the alteration of the stockholder's security occurs not because he consents to an exchange, but because *the corporation by authorized corporate action converts his security* from one form to another. That is to say (as indicated by the Note to Rule 5), there is no sale where (1) the vote of the stockholders is effective (subject to directors' action and other statutory requirements) as *corporate action* and (2) this action *binds all stockholders,* assenters, dissenters, and non-voters alike (subject only to appraisal rights of dissenters). The essence of the Commission's construction, as expressed in the Note, is that in such cases a proposed corporate act is submitted to stockholders to be accepted or rejected by them *as a class, in their capacity as members of the corporate body.* Even though the stockholder may participate in the vote which results in changing his rights as a stockholder, his action in so doing is the action of a member of the corporation exercising his franchise, rather than the action of a security-holder choosing to accept an offer of exchange made to him as an individual; and

obversely, the solicitation of his vote is nothing more than a request for the exercise of his franchise as a member of the corporation, not an offer of exchange or sale of new securities to him as an individual. He is functioning precisely as he would be if he were voting on a charter amendment which would, for example, change the corporate purposes. The fact that his rights will be changed if the consolidation or merger is effected is a mere incident of the corporate action in which he is participating."

In addition to the foregoing, and as a separate argument, the Commission stressed Section 19(a) of the Act. We quote it as follows:

"No provision of this title imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule or regulation of the Commission, notwithstanding that such rule or regulation may, after such act or omission, be amended or rescinded or be determined by judicial or other authority to be invalid for any reason."

We had in similar manner stressed Section 19(a). We need go no further than to quote from the Commission's brief as follows:

"The appellees assume that the Note constitutes a 'rule or regulation of the Commission' under Section 19(a), but contend that the Commission 'is without authority to create *exemptions* by rule or regulations' (Brief for Appellees, page 69). The pertinency of this contention is difficult to understand in view of the express language in Section 19(a): 'notwithstanding that such rule or regulation may, after such act or

omission, * * * be determined by judicial or other authority to be invalid for any reason.' The validity of this rule of the Commission is, therefore, immaterial to the applicability of Section 19(a) to protect the appellant. See Lee, *Legislative and Interpretive Regulations* (1940) 20 Geo. L. J. 1, 30-31."

We also argued that, for a case to arise under the Securities Act, it must be for the enforcement of a remedy given by that Act, and that petitioner was seeking no such remedy. We consider, however, that it would be superfluous to present this point.

3. The Petition for Rehearing in Bank.

Counsel point to no law or authority or to any rule or intimation by any court that counsel was entitled to have their petition passed upon by all of the Judges of the Circuit Court of Appeals for the Ninth Circuit. A rehearing *in bank* is not a matter of right. It is a matter of grace. If every petition for a rehearing *in bank* is required to be passed upon by the entire court, each such petition would in effect bring about such hearing, since all of the Judges would be required to pass thereon. If such rule were adopted, the very purpose of having more than three Circuit Judges in a Circuit would be largely thwarted. The purpose of additional Judges is to expedite the decision of cases; the rule for which counsel argue would decidedly slow down the procedure.

It is unnecessary to point out that counsel's argument has nothing whatsoever to do with the merits of the litigation.

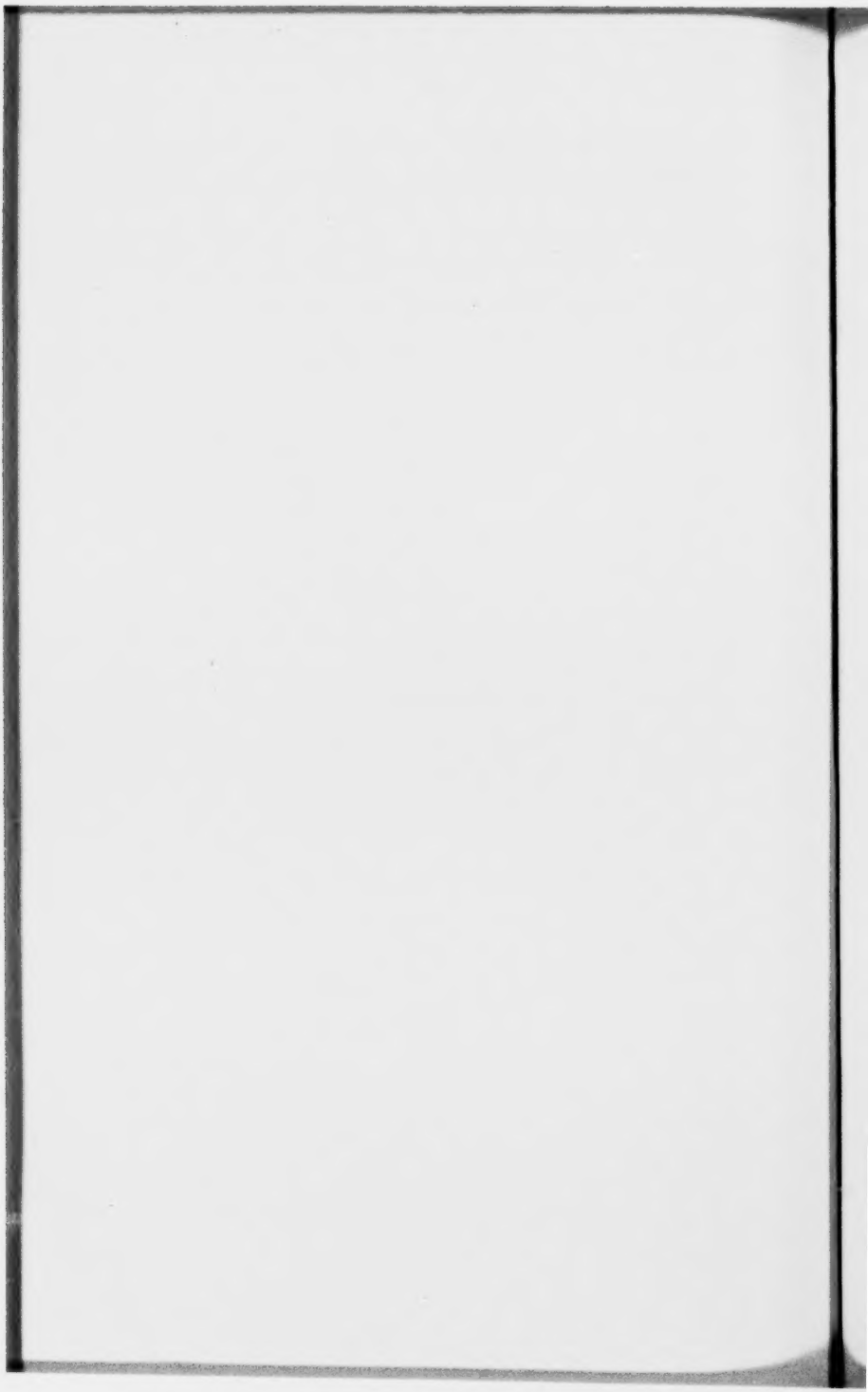
Respondent urges that the writ be denied.

Respectfully submitted,

ALLEN L. CHICKERING,
WALTER C. FOX, JR.,
VINCENT I. COMPAGNO,
111 Sutter Street,
San Francisco, California,
Attorneys for Respondent.

CHICKERING & GREGORY
111 Sutter Street,
San Francisco, California.
Of Counsel.

(APPENDIX FOLLOWS)



Appendix

The Note to Rule 5(2) of the Rules and Instructions accompanying Form E-1 of the Securities and Exchange Commission is as follows:

"NOTE: The Commission deems no sales to stockholders of a corporation to be involved, within the meaning of the definition quoted in Rule 5(2), where, pursuant to statutory provisions or provisions contained in the certificate of incorporation, there is submitted to the vote of such stockholders a proposal for the transfer of assets of such corporation to another person in consideration of the issuance of securities of such other person, or a plan or agreement for a statutory merger or consolidation, provided the vote of a required favorable majority

"(a) will operate, so far as the corporation the stockholders of which are voting is concerned, to authorize the transfer or to effectuate the merger or consolidation (except for the taking of action by the directors of the corporations involved and for compliance with such statutory provisions as the filing of such plan or agreement with the appropriate state authorities), and

"(b) will bind all stockholders of such corporation, except to the extent that dissenting stockholders may, under statutory provisions or provisions contained in the certificate of incorporation, be entitled to receive the appraised or fair value of their holdings.

"The Commission deems it immaterial in these circumstances whether the person the securities of which are to be issued is in existence or not; whether, if

such person is in existence, the plan, agreement or proposal is submitted by or with its authority; or whether, in the case of transfer of assets, such securities are to be issued to stockholders directly, or are to be distributed to them as a liquidating dividend or otherwise.

"When, in accordance with this Note, submission of a plan, agreement, or proposal to the vote of stockholders involves no sale to them, the Commission deems no sales to be involved in the delivery of securities to such stockholders.

"Accordingly, neither the submission to the vote of stockholders of a plan, agreement, or proposal of the character specified in this Note, nor the delivery of securities thereunder to such stockholders, requires the registration of such securities or the delivery of a prospectus meeting the requirements of Section 10 of the Act."